Which REITs Are the Safest Bets if Canada's Real Estate Bubble Bursts?

Description

News on the Canadian real estate market isn't encouraging these days.

In Toronto, Canada's largest city, home sales in June fell the most in the past eight years. As sales plunged, average home prices also dropped 14% from their peak, making the spectre of a possible housing bubble burst.

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This reversal in home prices comes after the provincial government imposed a 15% tax on foreign buyers in April to curb speculation as part of its affordable housing plan.

This changing dynamic of the Canadian real estate market raises this important question: Which real estate investment trust (REIT) can withstand a possible crash in property values if this sluggishness prolongs and develops into a long overdue correction?

The chances of such a scenario developing aren't very strong though. Most forecasters are predicting a soft landing rather than a crash in real estate values as demand dynamics remain strong, especially in the Greater Toronto Area and Vancouver.

But investors who earn a regular income from REITs have a reason to worry amid disturbing headlines in the financial press almost every day. After all, they saw the prices of some REITs drop by more than 50% during the 2008 Financial Crisis.

Another threat to the REIT sector comes from a possible interest rate increase by the Bank of Canada starting in July—a move which will increase the borrowing cost for REITs, leaving less for the profit distribution.

In this environment of uncertainty, I've picked the safest Canadian REITs which have solid business models and are in much better positions to withstand any economic shock or a sudden rise in interest rates.

RioCan Real Estate Investment Trust

RioCan Real Estate Investment Trust (TSX:REI.UN) is Canada's largest REIT and is anchored well to maintain its distribution. With 300 retail properties across Canada, it owns and manages the country's largest portfolio of shopping centres, including **Wal-Mart, Canadian Tire, and Cineplex**.

With the committed occupancy rate of 95%, RioCan tenants include very strong names that perform well in a recession due to their vast economic moats—a term used by Warren Buffett to describe companies commanding a strong competitive advantage over their rivals.

The most important performance criterium investors use to judge the performance of any REIT is its ability to maintain the cash flows to pay its unitholders. This ratio is called adjusted cash from operations, or AFFO.

In the case of RioCan, the trust is generating more cash than its distribution to unitholders. In first quarter of 2017, RioCan generated $0.44 per unit in AFFO and paid $0.35 per unit in distributions.

RioCan pays a monthly distribution of $0.1175 per unit. At the time of writing, the payout provides an annualized yield of 5.8%.

RioCan has also cut its debt by using proceeds from the sale of its U.S. assets last year, generating a cushion to shield itself from possible rate hikes. In the first three months of 2017, RioCan's total-debt-to-total-assets ratio was 40.8%, down from 45.6% in the same period a year ago.

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Chartwell Retirement Residences

Chartwell Retirement Residences (TSX:CSH.UN) is a Canadian REIT which also fits well in a conservative investment strategy to protect your capital during an economic downturn and continue to earn stable monthly income.

Chartwell Retirement is the largest operator in the Canadian senior living space, managing over 175 locations across four provinces in Canada. As the Canadian population ages, investing in retirement residences and long-term care facilities is probably one of the best strategies in the real estate sector.

And this is the reason that Chartwell Retirement has done much better when compared to the performance of **S&P/TSX Composite Index**. Over the past five years, its share value appreciated by 60%, almost double the returns of S&P/TSX index during the same period.

This REIT pays a stable monthly distribution of about $0.048 per unit, up 7% over the past five years. At the time of writing, the payout provides an annualized yield of 3.78%.

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