Income Investors: What's the Deal With 1-Tenant REITs?

Description

REITs come in many different flavours, but most income investors are probably most familiar with diversified REITs that act as a one-stop shop for all the main types of real estate, including retail, residential, office, or industrial properties. Each type of real estate has its pros and cons depending on the current economic environment, but usually, many investors can simply buy a diversified REIT, like **RioCan Real Estate Investment Trust** (TSX:REI.UN), and just collect those monthly cheques without worrying about a single point of failure.

In addition to being diversified across different types of real estate, many large, diversified REITs also have a well-diversified tenant base. That makes a lot of sense, because if one tenant goes bankrupt, then your distributions probably won't be in jeopardy; many passive investors may not even realize one of the REIT's tenants went belly up. A diversified tenant base sounds like a must-have for every sustainable REIT, but did you know that one-tenant REITs are on the rise? These are REITs consisting of just one major tenant.

Many major retailers have been spinning off their real estate assets into REITs to generate more value. **Choice Properties Real Est Invstmnt Trst** (TSX:CHP.UN) has **Loblaw Companies Ltd.** as its major tenant, and **CT Real Estate Investment Trust** (TSX:CRT.UN) has **Canadian Tire Corporation Limited** as its major tenant.

Why take on additional risk with one-tenant REITs?

If you know the importance of diversification, then you probably think one-tenant REITs are a ridiculous idea. If that one tenant goes out of business, then your distribution pretty much goes flying out the window. Why would you put all of your eggs in the same basket when there are great diversified REITs with hundreds or even thousands of different tenants?

Having one major tenant may sound like an extremely risky proposition, but it really isn't as risky as it sounds. Usually, the one tenant is a very large retailer that has been around for many years and will probably remain in business for many decades.

While having a diversified tenant base is great for reducing risk, it can also be a hassle, especially for

REITs with hundreds of different tenants, each of which needs to be monitored. There's a degree of uncertainty when dealing with so many tenants.

Some tenants may not decide to renew a lease; some may run into financial distress years down the road due to a changing environment. Not to mention that the REIT needs to hire additional employees to take care of the complexities that come with having a huge tenant base spanning various real estate types.

With a one-tenant REIT, you don't need to worry about the non-renewal of a lease. There's less complexity, more visibility, and, in many cases, one-tenant REITs usually give more bang for their buck when compared to a diversified REIT.

Dennis Mitchell of Sentry Investments states that one-tenant REITs cut both ways for the new REITs. Although they may not be diversified, they usually have a pipeline to new assets. If Loblaw decided to expand or acquire another grocery chain, the real estate would go into the Choice Properties trust.

Bottom line

One-tenant REITs aren't as risky as they seem. If you're an income investor who's hungry for yield, then you may want to consider adding a position of the REIT of your favourite retailer. Although there's less diversification, there are many advantages of having one major tenant.

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