Should You Buy RioCan Real Estate Investment Trust for Monthly Income?

Description

Retail real estate investment trusts (REITs) are at the cheap end of their valuation range. Certainly, retail REITs are more stable investments than retail companies, of which many are facing headwinds from the mega-trend of e-commerce.

Characteristics that make retail REITs more stable are their juicy monthly dividends and the fact that they earn rents from a diversified tenant base. Even if some tenants may be having trouble, it's unlikely that all tenants are facing difficulties.

Let's take a look at **RioCan Real Estate Investment Trust** (TSX:REI.UN), Canada's largest retail REIT, which has quality management and quality assets.

Management has been doing the right things

The space that RioCan used to rent out to **Target**, which exited Canada, had been filled with other tenants. From these spaces, RioCan was able to generate cash flows of 40% more than what Target would have generated.

RioCan began acquiring U.S. properties in November 2009 when valuations were cheap due to the Financial Crisis. During the ownership, the company generated nearly US$100 million of income. In 2016, RioCan exited its U.S. portfolio with a gain of about $930 million and used the proceeds to strengthen its balance sheet.

Quality locations

RioCan is now focused on Canada's urban markets and generates ~64% of its annualized rental revenue (ARR) from Ontario, ~15% from Alberta, 9% from British Columbia, and 8.6% from Quebec. Furthermore, it has a large tenant base of ~6,200 tenants with no tenant contributing more than 5% of its ARR.

RioCan's recent retention rate on lease expiries was 88.6% with an average rent increase of 8.2% on renewals and a 9.6% average increase on non-fixed renewals.

Tenants

RioCan's top tenants, which contribute 32.4% of its ARR and have a weighted average lease term of more than seven years, include **Canadian Tire**, **Loblaw** (or Shoppers Drug Mart), **Wal-Mart**, **Cineplex**, **Metro** (or its other banners), **Cara**, **Lowe's**, Sobeys or Safeway under the parent company **Empire**, and **Dollarama**.

RioCan generates 27.6% of its rent from restaurants, grocery, pharmacy, or liquor stores, 20% from personal services, and 14.5% from value retailers, which are relatively stable industries.

Investor takeaway

Although some of RioCan's retailers have left in the last year, others have been doing exceptionally well, including Marshalls, H&M, Zara, Winners, and Forever 21.

With a recent payout ratio of ~84% and a high occupancy of 96.2%, RioCan's distribution is safe. Currently, it yields ~5.8% at about ~$24 per share.

If it trades at a fair multiple of 15, it can deliver total returns of ~15% in the next 12 months while offering above-average income. So, RioCan should appeal to conservative income investors now and on any further dips.

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