Is it Time to Flee REITs After a Second Rate Hike?

Description

Contrary to conventional wisdom, rising rates are not historically indicative of weakness in the real estate sector. Strength in the economy usually translates to better performance in real estate markets as would-be buyers and renters are more inclined to spend in a better environment. This is also true for real estate investment trusts (REITs), though Canada has some notable exceptions which should give investors pause.

Canadian REITs boast long-term leases and low tenant turnover, which gives landlords less flexibility to changing economic times and to raise rents in response. Recently, the Ontario government made changes to the Residential Tendencies Act. Since May 30, 2017, landlords in Ontario can't increase the rent on most private rental units subject to restrictions set by the Rent Increase Guideline provided by the government of Ontario.

With this in mind, should investors be looking for other options?

REITs can still a good source of income for your portfolio

RioCan Real Estate Investment Trust (TSX:REI.UN) has declined 10.5% in 2017. The company announced its second-quarter results on August 3. Operating income was up 8.5% from Q2 2016 to $185 million, and revenue was up 3.6% to $286 million. Renewal rents increased on average 4.7%, and the retention rate jumped up to 93.9% in the quarter. RioCan still boasts a dividend of 0.12 per share, representing a dividend yield of 5.9%.

H&R Real Estate Investment Trust (TSX:HR.UN) has fallen 3.7% in 2017 and 6.3% year over year. The company released its second-quarter results on August 10. Property operating income declined by $4.2 million compared to Q2 2016. Lower deferred income taxes boosted net income by $49 million compared to the second quarter in 2016. The company announced a dividend of $0.12 per share, representing a yield of 6.4%.

Cominar REIT (TSX:CUF.UN) stock is down 9% in 2017 and 18% year over year. The company recently announced that it would sell its entire real estate portfolio outside its Montreal, Quebec City, and Ottawa/Gatineau markets. According to Cominar, the company has received significant interest in its Albertan properties. Cominar recently cut its distribution and offers a dividend of $0.09 per share at a yield of 8.5%.

Is it worth buying low right now?

I count myself on the skeptical side when it comes to rising interest rates. The Bank of Canada's recent decision to raise interest rates to 1% still puts them at historic lows. Canadian consumers are facing some dangerous margins with sky-high debt-to-income ratios; recent surveys revealed that many working Canadians can't afford to miss even one paycheque before beginning to miss payments.

Overleveraged citizens will force a cautious hand from the Bank of Canada. Economic growth is expected to slow in 2018 — a recent projection from the IMF — putting the growth rate at 1.9% in 2018. With these factors in mind, buyers of Canadian REITs could actually benefit from perceptions of an accelerated rate hike period which may never come.

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