Dividend Investors: This Top REIT Now Yields 6%. Time to Buy?

Description

After falling ~13% in the past year, **RioCan Real Estate Investment Trust's** (TSX:REI.UN) slide doesn't seem to be stopping any time soon.

Despite the company's solid position in the REIT space, investors aren't interested in buying the largest Canadian REIT. For income investors, does this dismal performance provide a buying opportunity or a time to exit?

Let's find out what the headwinds affecting the RioCan stock are.

Interest rate hikes

REITs generally outperform in an environment when interest rates rise. The reason is simple: a stronger economy means more opportunities for getting long-term leases and the higher occupancy rates.

But this economic logic doesn't work in Canada. RioCan and other similar REITs mostly have long-term leases and high debt loads. When interest rates rise, so do their borrowing costs. They're unable to pass on this higher cost to their tenants, because they've signed long-term leases with them with very little turnover.

This situation makes Canadian REITs bond-type securities, which are more sensitive to interest rate hikes.

After the two rate increases since July, the Bank of Canada could raise the borrowing two more times by the end of 2018, taking the benchmark interest rates to 2%.

Housing slowdown

The second factor scaring investors away from the Canadian real estate companies is the nation's overheated housing market. Since peaking in April, home prices in Toronto, Canada's largest city,have fallen more than 20% on average.

In a worst-case scenario, some investors fear that this cooling might turn into an ugly crash, taking down with it some highly indebted Canadians and overly exposed mortgage lenders.

That crash-landing scenario is also affecting other companies, such as alternative mortgage lenders and some banks.

The chances of such an outcome 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 regular income from REITs have a reason to worry. After all, they saw RioCan's stock price drop by ~60% during the 2008 Financial Crisis.

Should you buy or sell?

After this year's pullback, RioCan stock now yields ~ 6% on an annual basis, which is close to the best dividend yield on this stock since 2010.

I think the worries making investors nervous aren't stock specific. If you look at the company's balance sheet, its earnings, and future growth potential, you won't see dark clouds hovering.

I think this is a good entry point for dividend investors if they want to add a top-quality REIT to their portfolio. At a 6% dividend yield, you'll be getting a monthly distribution of $0.115 a share from a company whose tenants include some of the top retailers in the world.

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