First Capital Realty Inc. vs. RioCan Real Estate Investment Trust: The Rematch

Description

I'll discuss **RioCan Real Estate Investment Trust** (TSX:REI.UN) and **First Capital Realty Inc.** (TSX:FCR), two stocks I've covered several times over the past 18 months.

Personally, I've favoured First Capital over RioCan in recent articles.

However, the latest news that RioCan is selling most of its properties outside Canada's six major markets — Toronto, Montreal, Ottawa, Calgary, Edmonton, and Vancouver — for a possible $1.5 billion payday has me revisiting the two stocks to assess if anything's changed with this latest announcement by RioCan.

Not happening overnight

RioCan's announcement made it clear that this divestiture process is not going to happen overnight; it's likely to take up to three years, involving more than 100 properties from Ontario and Quebec and several other provinces to a lesser extent.

RioCan expects to use up to $750 million of the net proceeds to buy back its stock. If you're a fan of share repurchases, you're probably happy about this part of its plan. It will also use a portion of the proceeds to pay down some debt, while investing in its development pipeline that's expected to require up to $400 million annually over the next three years for projects in the six cities listed previously.

With the developments already planned or being planned, RioCan hopes to generate 90% of its annual revenue from the six major markets, up from 75% today. Also, its plan is to use mixed-use developments (office, residential, retail) to make this a reality.

“The repositioning of RioCan’s portfolio to further prioritize high-growth, high-population hubs will streamline our property and asset management platform, improve operating efficiencies and enhance the Trust’s competitive advantage,” stated Rags Davloor, RioCan’s president and COO. “Further, this will enable RioCan to capitalize on its portfolio of well-located properties, and support the ongoing development pipeline that will contribute to both RioCan’s long-term cash flow growth and net asset value creation.”

While this makes sense from a business perspective, it’s surely going to cause some unrest in places like London, Ontario, where the company owns 11 retail shopping centres.

“The growth is in the bigger markets and that doesn’t bode well for London,” stated London commercial realtor Richard Gleed October 3 in the *London Free Press*. “When any big REIT is offloading assets, you say, ‘Why? Are they losing faith in the market?’”

It’s not so much RioCan is losing faith in the London market as it is it can make more in places like Toronto and Vancouver. Like I said: you can’t fault the logic.

First Capital’s also selling

In 2011, First Capital entered a joint venture with Main and Main Developments, a Toronto-based company headed by Rick Iafelice, a commercial real estate veteran with +30 years of experience. The plan was to assemble parcels of land in desirable locations in Toronto and Ottawa that would welcome mixed-use developments.

In late September, the partners announced that they were putting the 2.1 million potential square feet, which is sitting on 10.7 acres of land, up for sale. Included in the portfolio are six income-producing properties. Estimates suggest the portfolio could be worth upwards of $550 million in the hands of the right investors.

While some may view the announcement as a sign that First Capital’s strategy is changing, others feel it’s simply an opportunity to cash out while the market is still hot.

“Really it’s a sweet spot to sell right now,” said Ross Moore, a senior vice president with real estate tenant advisors Cresa. “But you know, we’ve said this before, that it was the top of the market, and then it got hotter.”

Which is better?

While it’s easy to get all hot and bothered by RioCan’s strategic announcement which could net it $1.5 billion over the next three years, the sales process is not guaranteed, and it will take the company’s eye off the ball, if ever so slightly.

For me, a 4.3% dividend yield from First Capital is still a better choice than 5.7% from RioCan for two reasons.

First Capital’s business model of developing mixed-use properties anchored by grocery stores is a sound one. People have to eat, and the stores bring in foot traffic. Second, First Capital’s Main and Main Developments sale process will be handled externally, providing much less of a distraction.

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