What Should You Look for in a REIT?

Description

Be careful when investing in real estate investment trusts (REITs), which typically have slow growth. Most REITs don't increase their distributions every year. Higher interest rates are going to further dampen their growth.

As a result, it's very important to put a REIT investment in perspective in terms of what you expect to get from one. More importantly, never overpay for them, no matter how high quality they may be.

Look for big yields

REITs are income vehicles. Most pay monthly distributions, which are convenient to help pay the monthly bills. In my opinion, if REITs don't offer above-average income, there's no point in owning them. If they aren't going to offer much growth, the least they can offer are big yields.

At the market close on Wednesday, the **iShares S&P TSX Capped REIT Index Fund** (TSX:XRE) offered a yield of 4.93%. The fund's largest holding is **RioCan Real Estate Investment Trust** (TSX:REI.UN), which happens to offer a bigger yield of nearly 6%. So, it fits the "big yield" criterion.

RioCan hiked its distribution this year. Even though it was a small increase of 2.1%, it shows that management is confident in and committed to the distribution. RioCan's payout ratio is estimated to be roughly 80% this year, so the distribution should be sustainable.

Look for growth

Although RioCan doesn't look like it has much growth in the near term, it has room for a different kind of growth — that is, price appreciation, if the retail REIT trades at its normal multiple again.

Currently, at $23.65 per unit, RioCan trades at a multiple of about 13.2. If it reverts to the mean, the stock can appreciate more than 14%. Of course, there's no telling when that will occur.

Notably, not all areas of retail are on the decline. RioCan points out that certain areas continue to expand, including dollar stores and discount retailers, for example.

Look for quality

After selling its U.S. portfolio, RioCan paid down its debt. So, its balance sheet is cleaner than many other REITs' balance sheets. That said, it is still the largest retail REIT in Canada with a portfolio of about 300 properties across roughly 6,400 tenants. So, it's very diversified.

Another positive is that RioCan has relatively little exposure to Alberta, which contributes about 15% of its annualized rental revenue. The REIT also generates about 65% of its rent from Ontario and 40% from Toronto.

Investor takeaway

In summary, the best REIT investments are undervalued and offer sustainable, above-average yields and growth. Ideally, they should also have quality portfolios and balance sheets.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:REI.UN (RioCan Real Estate Investment Trust)
2. TSX:XRE (iShares S&P/TSX Capped REIT Index ETF)

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