A Rate-Sensitive Dividend Stock Is a Bargain for Income Investors

Description

When interest rates rise, investors dump equities that rely heavily on debt to grow their operations. In Canada, real estate investment trusts (REITs) and utilities are the two sectors that are under pressure since the Bank of Canada started hiking the borrowing cost.

After the pullback of the past three months, however, some of these rate-sensitive stocks are trading at very attractive values, offering income investors an opportunity to take advantage of these bargains.

Let's have a look at **RioCan Real Estate Investment Trust** (TSX:REI.UN) to see if it's offering a good bargain at the current price level.

RioCan REIT

Technically speaking, rising interest rates should be a good development for REITs. In an economy where the central bank raises the borrowing cost, there is more demand for commercial real estate, industrial warehouses, and residential complexes. Also, there is less of a chance of tenants going bust.

But for Canadian REITs, there is a negative side to this story as well. If interest rates start to rise quickly, some REITs might struggle. The ones that will be in trouble are those that have the highest leverage ratios.

REITs work just like fixed-income securities. They distribute most of their cash that they generate from long-term leases in dividends. As interest rates rise, so do REITs' borrowing costs. Because their leases are long term, they can't immediately seek more rent to balance the equation.

But RioCan, Canada's largest retail REIT, doesn't fall in this category. Its leverage ratio (total debt to total assets), at 41.4%, is well within a manageable level. The company owns and manages the country's largest portfolio of shopping centres with some top-quality tenants.

Another thing which is depressing the RioCan share price is that the company is in the midst of a major transformation, which includes exiting from some less-attractive markets and focusing on the sixlargest rental hubs in Canada.

In its latest update to shareholders, RioCan announced that it's making a good progress on this move. In the four months since the announcement of the strategy in October, RioCan has either completed or entered firm agreements to sell $512 million of properties in secondary markets, representing approximately 25% of the announced disposition target.

Should you buy RioCan now?

Income investors who like investing in REITs and are looking for a right entry point should take note of RioCan's very juicy dividend yield of over 6%, after its share price fell 11% during the past one year. Trading at $23.60 at the time of writing, RioCan's price-to-earnings multiple of 11.2 also looks very attractive to me.

With this positive note, however, investors shouldn't expect a major capital appreciation from this top REIT in the near term. This investment is good for long-term income investors who are building their retirement portfolios. For such investors, having some exposure to Canada's robust real estate market isn't a bad idea.

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