2 Severely Battered REITs to Buy in Today's Turbulent Market

Description

REITs aren't the best class of investments when interest rates rise, but at these levels, it appears that most of the bad news is already baked in to shares. Earlier in the year, everybody was frightened over the potential for surging interest rates and inflation. Some pundits even thought there could be four or more rate hikes in a given year, and the possibility of such a scenario sent shock waves across the entire market with many REITs, telecoms, and utilities falling by double-digit percentage points in a matter of weeks.

Sure, rising rates are not good news for REITs, but if safety and income are what you value most, then you shouldn't be throwing in the towel. In fact, you should take a contrarian stance by loading up on your favourite quality REITs in spite of long-term headwinds.

Everybody has had the chance to run to the exits already, and at this point, I think many REITs are severely oversold. Rapidly rising rates are indeed a headwind, but they're not a detriment to REITs, and, in most cases, the distribution is completely safe and will continue to grow in spite of harsher conditions.

Furthermore, everyone appears to be expecting an extremely hawkish tone from Poloz and company at this point in time, when in reality, Canadian interest rates may not rise as fast as many pessimists may be thinking. If that's the case, many high-quality REITs have a relative margin of safety at current levels.

Without further ado, here are two overly beaten-up REITs that you may wish to scoop up while interest rate fears are high:

RioCan Real Estate Investment Trust (TSX:REI.UN)

RioCan is Canada's largest REIT with over 350 retail properties across Canada and ambitious plans to expand into the residential space with over 10,000 units to be built in lively urban locations. The REIT is rate sensitive and is a great way to play the excessive fear of investors and their expectations of rapidly rising rates.

RioCan trades currently has a ~6.1% distribution yield and is off over ~20% from its all-time high. The REIT has a modest 41.4% leverage ratio and is by no means in serious trouble should rates continue on their upward trajectory, and if interest rates actually rise at a slower pace than what many of us expect, a potential near-term rally could be in the cards; however, as an income investor, I wouldn't bet on such an event happening. Instead, collect the attractive distribution for the long haul as you enter at what I believe are bargain-basement prices.

SmartCentres Real Estate Investment Trust (TSX:SRU.UN)

SmartCentres is another severely battered retail-focused REIT that's made a commitment to diversify into residential properties with ambitious development plans. The REIT has a distribution yield that's just south of 6% and, like RioCan, is currently off over 20% from its all-time high.

Rate-hike fears, along with concerns over the death of the shopping mall are overblown. Toys "R" Us is a known tenant of SmartCentres, and the recent bankruptcy has many investors even more gloomy over SmartCentres.

But there have been many offers for Canadian Toys "R" Us locations, so it appears that a U.S.-style shutdown is out of the question, especially when you consider the fact that the Canadian locations are faring much better. Unlike the U.S., the Canadian market still has a place for good old-fashioned shopping malls, and that's unlikely to change overnight, which means fears over vacancy spikes at SmartCentres are just as unwarranted as the excessive rate-hike fears.

Bottom line

Many REITs are facing immense pressures, and despite a more challenging environment, I think long-term income investors would be very wise to pick up bargains amid the carnage, especially since rising rates aren't really as scary as many REIT investors make them out to be.

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