Best Canadian REITs for Income Seekers

Description

Real Estate Investment Trusts (REITs) are held in high esteem by income investors. For tax reasons, REITs are required to pay out most of their cash to unitholders in the form of distributions. Cash flow is defined as funds from operations (FFO) or adjusted funds from operations (AFFO).

It is important to note, however, that dividends account for only a part of distributions — sometimes, a very small portion. Distributions also contain a combination of capital gains, return of capital, foreign income, and other income. It is for this reason we refer to the payout as distributions and not dividends.

As such, not all the distributions qualify for the dividend tax credit. It also leads to a very complicated process come tax time. It is for this reason that investors are encouraged to hold these trusts in their Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP).

With respect to yield, REITs can be separated into two buckets: high and low distribution growth. There is usually a trade-off. If a Real Estate Trust has a high starting yield, it will typically have lower distribution growth. On the flip side, one with a lower starting yield will have a higher payout growth rate.

High yield, low growth

RioCan REIT (TSX:REI.UN) is the largest Canadian REIT with a market capitalization of approximately $8 billion. Approximately 30% of its revenues originate from high-quality national tenants such as **Cineplex, Walmart**, and **Dollarama.**

The company is beginning to diversify away from retail and expects to generate approximately 10% of its revenues from residential properties.

RioCan kept distributions steady from 2012 until it finally raised them this past December. The raise was expected, as its payout ratio as a percentage of FFO has been trading downwards. In the first six months of 2018, its payout ratio stood at 78%, down from 85.5% in 2014.

It currently yields 5.7%, which is attractive for income investors.

RioCan also provides great value. The company is currently trading 42% below its enterprise market value of $13.7 billion. It is also trading well below its historical price-to-earnings (P/E) ratio of 16.2. Should the company trade in line with historical averages, investors would be looking at a 28% gain.

High growth, low yield

On the opposite end of the spectrum we have **InterRent** (TSX:IIP.UN). InterRent is a Canadian Dividend Aristocrat, having raised dividends for six consecutive years. Its three- and five-year distribution-growth rates are 6.7% and 12.6% — tops in the industry.

The company has a low starting yield of 2.33%. However, it has been one of the best industry's performers. Year to date, it has returned 26.5% and 48.56% over the past year. In an industry dominated by established names such as RioCan, this type of growth is a rarity.

Despite its outperformance, InterRent also happens to be one of the most undervalued Aristocrats. The trust is currently trading at a 40% discount to its enterprise value and has a current P/E of 5.08.

The company is a steal at today's prices. Analysts agree. All 12 covering the company rate it a buy.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

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1. TSX:IIP.UN (InterRent Real Estate Investment Trust)
2. TSX:REI.UN (RioCan Real Estate Investment Trust)

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