A 6.4% Dividend REIT Income Seekers Can't Ignore

Description

With over 751 properties with over 66 million square feet of leasable area, **Choice Properties REIT** (TSX:CHP.UN) is the largest commercial real estate investment trust (REIT) in the country. With a 6.4% dividend yield, it's also one of the most attractive income stocks on the market.

While the market frets about a potential recession and the real estate sector takes a beating, it may be a great time to hunt for bargain dividends in this space. CHP is down nearly 12% over the past 12 months compared to a 11.1% drop for the **S&P/TSX Composite Index**.

However, CHP has vastly underperformed the **iShares S&P/TSX Capped REIT Index ETF**, which is flat over the same period. That underperformance is surprising for a number of reasons.

CHP offers investors a 43.92% payout ratio, which is one of the lowest in the industry. It has a recent funds from operations (FFO) payout ratio of about 71% and a sustainable adjusted FFO payout ratio of about 83%. This implies the dividend has room for growth.

The REIT's former parent **Loblaw** is still a primary tenant, responsible for the portfolio's 99% occupancy rate. The merger with Canadian REIT brought office, retail, and industrial assets to the combined portfolio. CHP is now one of the most stable and well-diversified REITs with a long track record of dividend growth.

However, the diversification doesn't seem to be going far enough for CHP investors. Of the 751 properties, only 206 were acquired from Canadian Real Estate Investment Trust (CREIT). Nearly half of CREIT's property portfolio is retail.

This means the majority of CHP holdings are leased by retail stores, and the trust's earnings are overexposed to Loblaw. Grocery chain Loblaw hasn't had a great year. The company's earnings fell by 67.1% over the past 12 months, while the Canadian consumer retailing industry grew by 33.1% during the same period.

In my opinion, Loblaw's struggles in the near term, combined with the general shift towards e-commerce, will have a sizable impact on CHP's earnings over the medium term. The trust will need further acquisitions and renovations to make retail properties mixed-use to survive the seismic shifts in Canadian retail.

That's where parent company **George Weston** comes in. The food processing and distribution conglomerate operates in a non-cyclical sector, which means its cash flow should remain stable regardless of the economy.

The company has nearly $1.8 billion in cash and cash equivalents on its books. Combined with the $84 million cash on CHP's book, the REIT has more than enough firepower to buy commercial real estate in the next market correction.

Bottom line

Choice Properties is a well-managed REIT with an attractive dividend yield and a sizable portfolio. However, the portfolio is too concentrated in the supermarket retail sector, which exposes the underlying earnings to risk in the near term.

I believe parent company George Weston's plan to diversify the portfolio further is matched by its financial strength. However, long-term investors should wait and watch the stock to see how this strategy pans out.

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