1 High Yield REIT to Consider for 2019

Description

As an alternative asset class to stocks and bonds, real estate investment trusts (REITS) have offered some important portfolio diversification benefits to Canadian investors and the asset class even outperformed the broader TSX in 2018.

The real estate market could be weaker in 2019 and in the short term, but the sector has become a very important income generator in dividend focused portfolios, as it has offered stable regular payouts with better yields than bonds in a low interest rate environment.

Although the Bank of Canada has been slowly increasing interest rates of late, bond rates are still near historical lows and the generally low yields on bonds may need be augmented by other stable income sources, although these alternatives do introduce higher volatility to portfolio values and increased investment portfolio risk.

One important growing REIT is in focus today.

Slate Retail REIT

Slate Retail REIT (TSX:SRT.UN) is one of the few REITs that I recommended in April 2018. The REIT's is focused on U.S. grocery-anchored shopping centres and its asset portfolio has been producing quite resilient cash flows that have supported stable distributions and generated good internal yields over the past few years.

Management announced a 1.8% distribution increase for December 2018 to US$0.071 a unit, which was a fifth consecutive annual distribution increase since the REIT listed on the TSX back in 2014. Growing net operating income generation and improving portfolio occupancy rates strongly support distribution increases.

The units offer a juicy 9.1% annualized distribution yield today with an expected 2018 AFFO pay out rate of 87.8%, which is not very far from Canadian retail REITS' average of 84.2%, although the quarterly pay-out rate spiked beyond 100% for the third quarter of last year.

Portfolio occupancy increased by 0.4% during the third quarter of last year to 94.3% and this level is much higher than the 92.6% achieved during a comparable quarter in 2017. Slate's portfolio has achieved a 90.2% tenant retention rate since inception, and high occupancy levels are expected to be maintained in the long term.

The REIT returned a negative 1.39% in total returns, which is mainly due to a significant plunge in the overall market in December. However, the units have since recovered much of late 2018 valuation losses and this could be a show of some valuation resilience and a big vote of confidence in the REIT's economic profile by the public market. I like that.

Compelling valuation?

At today's price, the units trade at a discount to net asset value of about 15%, offering new investors some margin of safety. The AFFO price multiple of 10.1 times estimated 2018 AFFO is very cheap as compared to industrial average of 14.0 times for Canadian retail comparable offerings and 14.5 times for U.S. comparables.

The REIT's total debt ratio at 58.6% is on the high end of the industry peers' average of 47.3% for Canadian peers and 38.4% for U.S. peers, but fears of further interest rate increases have since been dampened by slowing global demand and stalling economic growth, which could slow down interest rate growth pressures in global capital markets.

Most noteworthy, the REIT entered into $350.0 million notional amount pay-fixed receive-float interest rate swaps on July 30, 2018. By September 30, 2018, about 98.8% of the REIT's debt was subject to fixed rates, so investors may not have to worry about interest rate increases in the short term.

One last thing: Slate offers some exposure to foreign currency gains. Canadian investors receive their distributions in the CAD equivalent of the monthly distribution at the date of payment based on the U.S. Dollar/Canadian dollar exchange rate at the time of payment of the distribution, or they may elect to receive the monthly distribution in USD.

The distribution yield may increase with a weakening of the Canadian dollar against its United States counterpart should there be any such weaknesses during the investment period.

Investor takeaway

Slate Retail REIT operates a strong and resilient real estate income portfolio with exposure to a defensive retail sector, and its robust redevelopment pipeline could generate sustainable strong cash flow growth in the near term.

The units offer a compelling distribution yield today.

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TICKERS GLOBAL

1. TSX:SGR.UN (Slate Retail REIT)

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