Does the Retail Apocalypse Mean Investors Should Avoid Choice Properties REIT (TSX:CHP.UN)?

Description

While many U.S. shopping mall owners such as leading retail REITs **Washington Prime** and **CBL & Associates Properties** suffer from the apocalypse in bricks and mortar retailing, Canadian retail REITs continue to thrive. Washington Prime has seen its stock tank by 30% over the last year, while CBL has lost a massive 80% compared to Canada's largest retail REIT **Choice Properties REIT** (TSX:CHP.UN) gaining 12%.

The retail meltdown gains momentum

It isn't difficult to see why U.S. mall owners appear to be caught in a terminal decline. Occupancy rates have fallen sharply as the pace of retail bankruptcies, and store closures have moved rapidly. U.S. retailers have already announced that roughly 6,000 stores will close this year — a number that will continue to grow over the remainder of the year. Over 12 major retailers have filed for bankruptcy protection during the first four months of 2019.

The volume of bankruptcies will continue to pile up as competition from Amazon and other online retailers grows. Analysts have estimated that retail sales during 2019 will expand by around 22% compared to a year earlier, placing further pressure on bricks and mortar retailers as well as shopping mall owners.

The fallout for U.S. retail REITs becomes clear when reviewing Washington Prime's first quarter 2019 results, where rental income declined 5% year over year on the back of a 0.4% fall in occupancy. The results for CBL have been far worse, which can be attributed to its high proportion of lower tier properties.

The growing view among analysts is that Canadian malls are more productive than those in the U.S. because they are better designed and possess a superior atmosphere. According to the Retail Council of Canada, domestic malls are generating sales of around $800 per square foot compared to around $620 south of the border.

There has also been a tendency in Canada to focus on attracting more lifestyle tenants, making malls less reliant upon big box department stores, which are among the hardest hit by the transition to online shopping.

Choice Properties reported a first-quarter 2019 occupancy rate for its entire portfolio of properties of 97.4%, which, while 1.1% lower than a year earlier, was still higher than many of its U.S. counterparts. It should also be noted that the occupancy rate for that period for Choice's retail operations was 97.8%, well above the 97.2% and 92.2% for its industrial as well as office portfolios.

Choice Properties top retail tenants are also businesses that have proven themselves to be relatively resilient to the transformation of traditional bricks and mortar retailing. Its largest tenant by share of gross rental revenue is leading grocery retailer **Loblaw**. Similar to other necessity-based retailers, grocery chains have proven relatively immune to the boom in online shopping. Thrift store **Dollarama** is the fourth-largest tenant, another form of retailing that has proven quite resilient to the significant headwinds facing the industry.

There are no material lease expiries for its retail properties until 2023, which provides the REIT with ample time to monitor the fallout from the transformation underway in the retail industry and adjust its operations accordingly. For these reasons, it's certainly feasible that Choice Properties' core tenants will provide a reliable source of income, which explains why Choice Properties has not suffered the same fate as U.S. retail REITs, nor been harshly handled by the market like Washington Prime or CBL.

What does it all mean?

Choice Properties is an investment that should be considered by income-focused investors hungry for a recurring passive income stream. It pays a regular monthly distribution yielding 5.5%, which, with a payout ratio of around 80%, is sustainable. That payout is enhanced by the nature of Choice Properties tenants, its deep relationship with Loblaw and the quality of its assets. For those reasons, it's unlikely to suffer the same fate of Washington Prime or CBL, making it an attractive investment for those investors seeking a stable source of income.

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