2 Best Credit-Rated Canadian REITs to Buy in 2020

### Description

In one stock selection strategy by dividend income investors that aims to minimize the likelihood of future potential dividend cuts, credit ratings play an important role, and only investment grade-rated companies' stocks and real estate investment trusts (REITs) with a rating of BBB (high) or better are eligible for consideration.



The strategy is even more applicable to REITs, as those trusts that pose lower credit risk to unsecured-debenture investors (and therefore receive higher credit ratings) have better access to cheaper financing, and this allows them to better fund new development projects and property acquisitions and to generate higher-leveraged returns and realize higher growth rates.

Debt is a critical source of growth capital for these real estate operators, which are required by law to pay out almost all their earnings each year to investors so as to maintain their tax-advantaged status. Thus, among other favourable attributes, Canadian REITs with higher corporate credit ratings have better growth prospects than lower-rated ones.

That said, due to their naturally high leverage, most trusts barely make it higher into the investment grade hierarchy, and those that do are usually just a notch or two above the speculative (BB) rating.

I have three good investment candidates based on this criterion, included a recently upgraded one.

## The recently upgraded smart operator

**SmartCentres Real Estate Investment Trust** (TSX:SRU.UN) is one Canadian retail property owner that has been transforming itself into a mixed-use assets owner through a massive development program of rental apartments, condos, and other mixed-purpose properties on its existing retail assets, which is helping maintain very high occupancy rates and improving cash flows. An announced $12.1 billion, five-year "intensification program" could significantly boost earnings and valuation.

Management is upbeat that 2020 is a transformative year for the trust, as it expects incremental cash flows from new mixed-use properties that will open for occupancy this year, but the trust had already gotten positive recognition from credit-rating agent DBRS Morningstar late last year.

SmartCentres received a credit-rating upgrade on its unsecured notes in December last year. The rating improved from BBB to BBB, as the agency noted its improved risk profile to unsecured lenders after repaying $213 million mortgage debt during the fourth quarter of last year.

The total debt ratio has gone down to 42.3% exit 2019, and if unsecured lenders are safer holding the trust's units now, then the distribution to equity investors, which ranks lower but closer to unsecured debt, should be much safer too, all else equal.

Units currently yield 5.77%.

## A tried and tested trust

**RioCan Real Investment Trust** (TSX:REI.UN ) is one of Canada's oldest and largest REITs with a 23-year track record of stellar real estate portfolio development and management that generates strong cash flows and provides investors with a reliable monthly distribution payout.

The trust enjoys a BBB credit rating from DBRS Morningstar with a stable trend, and a BBB rating from S&P with a stable outlook. Its property portfolio employs a low leverage with a total debt-to-assets ratio of just 43.6% by September 2019.



Like SmartCentres, RioCan is also moving away from pure retail properties to create a predominantly mixed-use property portfolio with a robust 27.4-million-square-feet development pipeline of largely self-funded residential properties currently underway that will strengthen the trust's cash flow generation power and improve net asset value per share.

Units currently yield 5.19% with a very reasonable FFO pay-out rate that has improved from a high of 90.4% in 2013 to 77.4% during the third quarter of last year thanks to growing occupancy rates, higher net rentals per square feet, and consistent net-operating income growth rates.

## Foolish takeaway

Buying into investment grade-rated issuers could reduce the risk of distribution and dividend cuts in an income-oriented portfolio, and the two REITs opportunities highlighted today offer very reliable +5% yields, which could grow with some distribution increases over the next few years, as massive development plans contribute new and modern high-value, income-generating properties to their portfios over the next five years.

I expect their unit prices to keep growing with net asset value in the near future as new properties come online.

**CATEGORY**

1. Dividend Stocks
2. Investing

**TICKERS GLOBAL**

1. TSX:REI.UN (RioCan Real Estate Investment Trust)
2. TSX:SRU.UN (SmartCentres Real Estate Investment Trust)

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