Market Crash: How Much Will Canadian REITs Cut Their Dividends?

Description

During this COVID-19-triggered market crash, some Canadian REIT (real estate investment trust) stocks have fallen more than others. This has allowed investors to identify the more greatly impacted Canadian REITs.

Many investors buy REITs for the main purpose of generating income. Therefore, it's important to determine if dividend cuts may come (and prepare for them) in this COVID-19 pandemic period.

Most REIT dividend cuts will be temporary, as the economy will return to normal eventually after the pandemic passes.

Let's explore some factors that could lead to dividend cuts at the Canadian REITs.

What's the severity of rent reduction?

The value of real estate portfolios come primarily from their cash flow generation via rental income. Secondarily, the real estate properties can be sold for long-term price appreciation.

Unfortunately, during this COVID-19 period, most REITs aren't getting rental income at full capacity.

For example, **RioCan REIT** has retail properties in six major Canadian markets (including the GTA area). It has more than half of its tenants being forced to close their businesses due to the virus. As a result, the REIT expects to eventually collect only 83% of its April rents, as it allowed for some rent deferrals for 60 days.

Since REITs pay out cash distributions from their rental income, any rent cuts increase the danger of their cash distribution payment. Additionally, it's going to take time for the economy to recover, even when the COVID-19 situation is over.

Therefore, REIT results are expected to worsen in Q2 and Q3 before they get better.

Is the REIT financially strong?

A reduction in rental income leads to higher payout ratios. Even when payout ratios are temporarily high, REITs can still maintain their cash distributions, but should they?

As leaders of a listed company, management needs to balance the act of being responsible to (income or retired) shareholders and improving the liquidity and financial position of the company to weather an economic downturn.

If a REIT wasn't very strong financially before the COVID-19, then, there's a greater chance it'd need to cut its dividend more severely than another, better-capitalized peer.

Foolish investor takeaway

Even if REITs want to maintain their cash distributions, they may not be able to if they get substantial rent cuts for an extended time. Particularly, retail REITs are most impacted by COVID-19.

Currently, investors are better off thinking that high-yield REITs with retail exposure like RioCan and **H&R REIT** could cut their cash distributions by about half, which would lead to effective yields of about 4.9% and 7.5%, respectively, in the near term.

Then there is defensive healthcare REIT **NorthWest Healthcare Properties REIT**. It has a decent balance sheet and a portfolio that is about 97% occupied. Moreover, the portfolio is diversified across 1,900 tenants and substantially underpinned by public health care funding. It should be able to better protect its high yield.

The rental income of quality residential, office, and healthcare REITs is more solid. They include **Canadian Apartment Properties**, **Allied Properties REIT**, and NorthWest Healthcare, which currently offer yields of about 2.9%, 3.9%, and 8.4%, respectively.

However, the valuations of Canadian Apartment Properties and Allied Properties REIT are pretty high. Other than dividend cuts, valuation risk is something else investors need to watch out for.

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