Retirees: Are REITs Still a Dependable Source of Monthly Income?

Description

Many Canadian retirees are in a tough spot. The coronavirus pandemic has decimated shares of many REITs, causing some to lose well over half of their value. As concerns surrounding rent collection, deferrals, and the potential long-lasting permanent damage to the demand for specific real estate sub-industries continue to weigh, many retirees are at odds as to what to do next as distribution cuts loom.

The insidious coronavirus has disrupted the operating cash flow streams of many businesses, leaving many managers with few options other than taking the axe to their dividends (and distributions).

In this horrific environment, where liquidity (and unfortunately, solvency for a select few firms) has dried up, it doesn't make sense to borrow money to finance lofty dividend commitments.

To many income investors, dividend cuts are unacceptable and unforgivable

With tonnes of layoffs and furloughs, these are critical times where people need their investment income most. As such, dividend (or distribution) reductions at a time like this are viewed as unforgivable for many investors.

For the most-affected REITs such as those with a substantial weighting in the office and retail real estate sub-industries, distribution reductions are almost a guarantee, with yields swelling into high double-digit territory.

But if you're a retiree who got slapped with massive paper losses, does it make sense to continue hanging onto such hard-hit REITs while collecting monthly income payments that are at risk of being slashed in half?

Or should you cut your losses and seek out a more resilient dividend payer that's better positioned to ride out this coronavirus crisis?

A former monthly income market darling implodes

Consider shares of **H&R REIT** (TSX:HR.UN), a diversified REIT once viewed as a reliable source of income for many retirees. Thanks to a heavy weighting in the retail and office properties, the coronavirus crash sent shares of the REIT tanking around 65% from peak to trough, causing the yield to swell above the 17% mark.

For retirees that hung on, sadly, they could see as much as half of their monthly distributions taken away. But as Kay Ng, my colleague here at the Motley Fool Canada, noted in a prior piece, even a substantial distribution reduction still makes H&R REIT a bountiful buy at these depths.

“Receiving lower rental income, H&R REIT might cut the cash distribution by 30-50%. That would lead to an effective yield of 6.7-9.4% based on its quotation of $10.30 per unit at writing,” Kay wrote. “In the event of a dividend cut, I trust that management will restore the dividend to previous levels when the economy turns around.”

After surrendering a chunk of the relief rally over the last week, H&R REIT now sports a near-17% yield, which would work out to be a massive 8.5% if it were cut in half. And in a return to normalcy, H&R REIT could very well re-instantiate its original distribution amount.

But given the possibility of long-lasting damage done to the office and retail space, I’d argue that such a scenario is becoming more unlikely by the day.

Foolish takeaway

Even if the coronavirus were to be eradicated sooner rather than later, many firms might never return to the office. Some firms are flirting with bankruptcy and will be unable to renew a lease, and others, like Jack Dorsey’s **Twitter**, may have no use for office space in the future after stating that his employees can work from home “forever” if they so desired.

Many firms may follow in Dorsey’s footsteps by embracing telecommuting, which would blow a hole in the office real estate market.

That’s the real risk to REITs with office properties — not just the intermediate-term damage caused by the coronavirus, but also the potential for permanent damage. As such, I’d urge retirees to steer clear of super-high-yielding REITs with significant office exposure, as pre-pandemic demand for office real estate may never return and retirees could be left holding the bag when all is said and done.

I’d urge retirees to choose lower-yield REITs that aren’t operating in real estate sub-industries in the blast zone of the coronavirus crisis.

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