REITs Are Vulnerable: Riocan (TSX:REI.UN) Slashes Dividends by 33%

Description

The pummeling of real estate investment trusts (REITs) in Canada continues in the pandemic. In the stock market, the values of selected REITs are dropping significantly. One of the largest in the sector, **RioCan** (TSX:REI.UN) is in dire straits. The stock price of this prominent dividend-payer sunk to a low of $11.61 on March 23, 2020.

RioCan shares have risen since and now trades at $17.31 per share, although the real estate stock is still losing by 30% year to date. However, income investors were taken aback by a recent announcement. Because of the challenging environment, RioCan slashed its dividends by 33%. The reduction is effective in January 2021.

Broken promise and record

Back in May, RioCan CEO Edward Sonshine assured investors that no dividend cut was forthcoming. The narrative has changed after seven months. According to Sonshine, it has become necessary to protect and have the strongest balance sheet. Thus, RioCan broke its consistent high-dividend track record since February 2018.

Sonshine thought the market was only over-reacting, but realized that the pandemic won't go away yet despite the development and potential rollout of COVID-19 vaccines in 2021. RioCan will not raise its leverage beyond its current payout, said Sonshine.

Armageddon for retail REITs

RioCan has a market capitalization of $5.5 billion. The REIT owns, operates, and manages 221 properties. However, because it's retail-focused, the business is hurting. The retail space is in distress, mainly due to lockdown measures. Dozens of retailers are struggling to keep their businesses afloat.

Similarly situated and underperforming on the TSX are retail REITs **SmartCentres** (-19%) and **Plaza** (-17%). However, **Canadian Tire REIT** (+35%) and **Crombie** (+22%) are enduring the carnage. Even if

COVID-19 is a temporary inconvenience, the retail landscape will never be the same again.

Unknown future

The resumption of business activities in the most recent quarter improved RioCan's rent collections. From 78.1% in Q2 2020, it increased to 90.9% in Q3 2020. However, the REIT reported a net loss of $130.4 million in the nine months ended September 30, 2020, versus the $625 million net income in the same period last year.

RioCan is unsure of the pandemic's duration, so its board of trustees decided to take prudent action by reducing distribution and payouts to investors. Sonshine said, "We believe the current circumstances present an opportunity for us to optimize our capital allocation toward accretive initiatives."

By slashing dividends by 33%, RioCan expects an estimated $152 million in additional cash flow annually. The REIT remains committed to drive value creation for unitholders and increase distributions from this new base as conditions permit.

RioCan will use the additional capital to finance initiatives that will deliver long-term net asset value growth for unitholders. Such funding activities include mixed-use residential developments, unit buybacks through the normal course issuer bid program, and debt repayment. The REIT will also be on the lookout for any emerging opportunities.

Regular dividend evaluation

RioCan's Board of Trustees has assessed the current situation and believes the payout reduction is appropriate. While the REIT's portfolio is well positioned and liquidity is deep, the challenging environment warrants a more conservative payout ratio. The Board will reevaluate the distribution regularly, considering such factors such as cash flow, leverage and market stabilization as the health crisis dissipates.

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Date
2025/08/24
Date Created
2020/12/14
Author
cliew