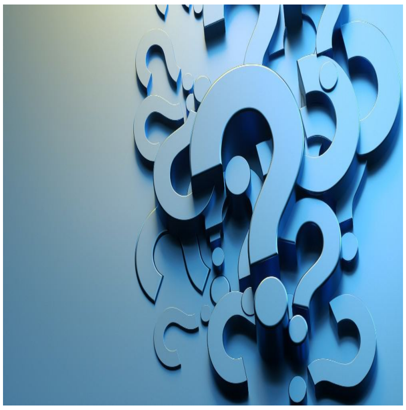

Should You Buy RioCan (TSX:REI.UN) for the 5% Yield?

Description

RioCan Real Estate Investment Trust (TSX:REI.UN) recently hit a 12-month low. Income investors are now wondering if the REIT is undervalued and a good stock to buy.

RioCan overview

RioCan owns shopping malls and mixed-use properties primarily located in six major Canadian urban centres. The business took a beating during the pandemic when lockdowns forced malls to close. Many of RioCan's tenants saw revenues plunge, making it hard for them to pay their rent.

Government-assistance programs along with special arrangements negotiated with RioCan helped keep most of the tenants from going bust or from being forced to vacate their store spaces. RioCan also benefitted from having several large anchor tenants that remained open during the lockdowns due to the essential goods and services they sell. These include the grocery stores and pharmacies, among others.

Despite the assistance, some businesses simply didn't make it through the downturn and the unknown duration of the pandemic forced RioCan to make a difficult decision. RioCan had initially said its distribution would be safe, but management eventually slashed the payout by 33% in January 2021, cutting the monthly allocation from $0.12 to $0.08.

The move shouldn't have been a surprise, but income investors who trusted management's assurance that the payout was safe got burned.

Now that malls are open again the revenue stream is back on track, and RioCan is investing for future growth. The company is building mixed-used properties that have residential rental units above the retail space. Demand for high-end apartment space in the city core should rebound as companies bring workers back to the office. A lack of affordability due to high interest rates and soaring property prices will bring more professionals into the apartment market.

Risks

REITs carry significant debt, so rising interest rates could eat into cash flow that is available for distributions. RioCan has a strong balance sheet and isn’t at risk of going bust due to its debt levels, but the company will eventually have to replace existing cheap debt with debt that could be at much higher rates. If revenue growth doesn’t keep up with the increase in borrowing costs, investors could see payout hikes stall.

Another distribution cut could occur if things get really ugly.

Recession fears are putting added pressure on RioCan. High inflation is already forcing households to trim discretionary spending. Rising interest rates will compound the problem. People will spend less money in stores that don’t sell essential goods. Weaker retailers could be forced to close if shoppers disappear. In a severe downturn a wave of closures would hit RioCan’s revenue stream and potentially make it hard for the company to find new tenants at attractive lease rates.

Is RioCan a buy today?

RioCan trades near $20 at the time of writing compared to $26 in March. The current monthly distribution of $0.085 provides an annualized yield of 5%. The board increased the payout earlier this year, so investors should feel confident the current distribution will be safe.

Income investors who think the economy will avoid a recession or only endure a short downturn might consider taking a small position at this level and look to add to the holding on additional weakness. I would probably search for other opportunities that offer growing dividends and similar yields today.

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