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The Newest Dividend King: Federal Realty Investment Trust

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by: Sure Dividend

Summary

- Federal Realty Investment Trust has now paid increasing dividends for 50 consecutive years.
- The company is targeting Southern California for expansion thanks to its strong population growth.
- Federal Realty Investment Trust saw steady or rising Funds From Operations per share through the Great Recessions, a rare feat for a REIT.

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Dividend history matters.

It takes a durable and defensible competitive advantage to deliver rising dividends for long periods of time. All else being equal, a company with many years of steadily increasing dividends is more likely to deliver rising income during the future.

That’s why the Dividend Kings are an excellent place to look for potential investments. To be a Dividend King, a company must increase its dividend each year for *50 consecutive years*.

You can see the full list of Dividend Kings here.

It isn’t every day that a company increases its dividend for the *50th straight year*.

However, Federal Realty Investment Trust (FRT) recently did just that, making it the newest member of the Dividend Kings.

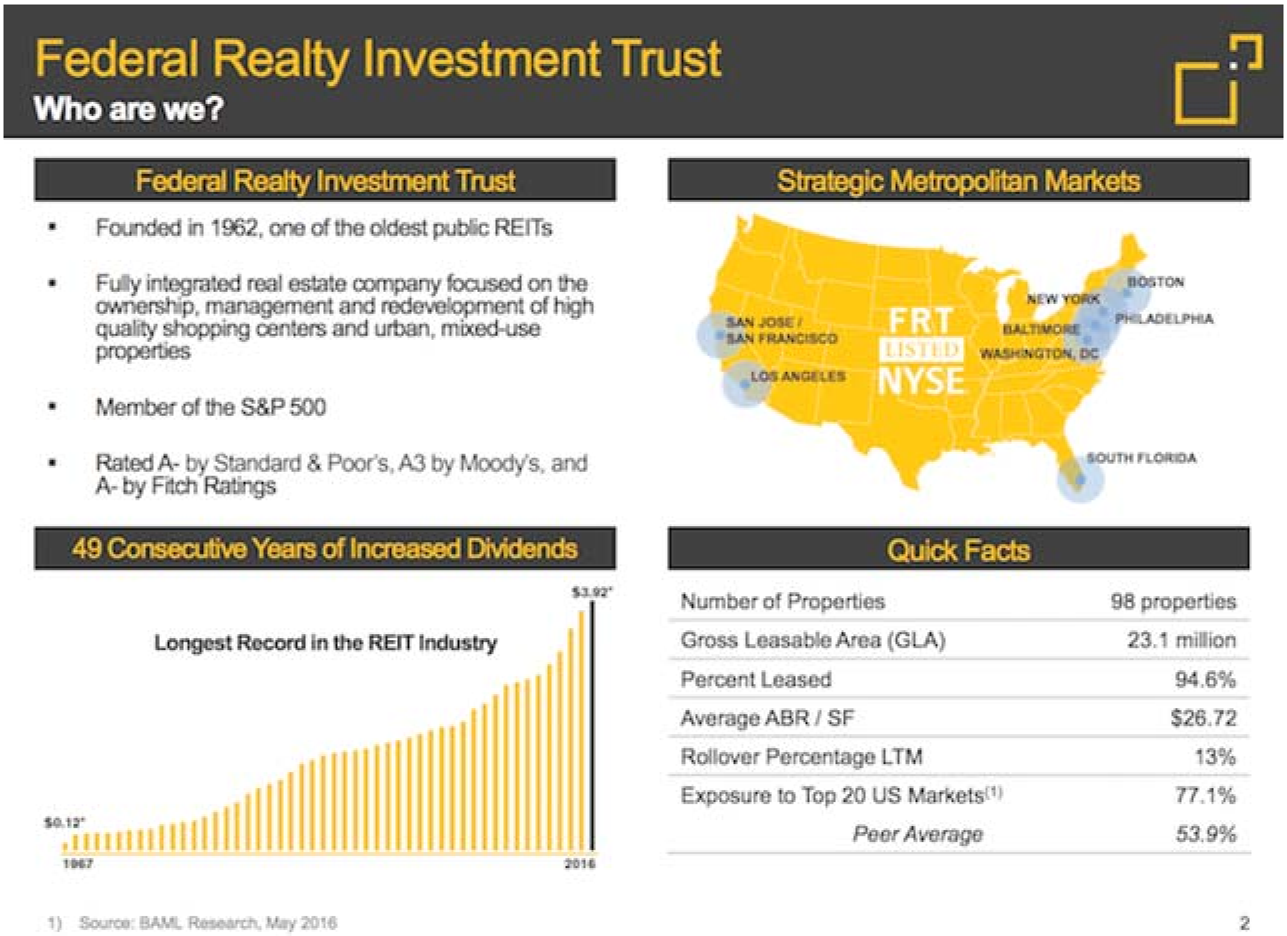
Something must be special about Federal Realty – it stands out as the only real estate investment trust to be a member of the Dividend Kings.

With that in mind, this article will analyze the business model and investment prospects of Federal Realty Investment Trust in detail.

Business Overview

Federal Realty Investment Trust is a real estate investment trust (REIT) that focuses on the ownership, management, and redevelopment of high-quality shopping centers and mixed-use properties in urban locations.

The trust is a member of the S&P 500 and has impressive size, with 98 large mall properties, 23.1 million square feet of gross leasable area, and a market capitalization of nearly $10 billion. The majority of Federal Realty's properties are in cities near the U.S. coastlines, including Los Angeles, New York, Boston, San Francisco, and Philadelphia.



Source: Federal Realty Investment Trust First Quarter 2017 Investor Presentation, slide 2

Federal Realty has the longest record of consecutive dividend increases of any real estate investment trust, of which there are about 172. It is also the only REIT to be a Dividend King.

Interestingly, this is also Federal Realty's first year as a member of the Dividend Aristocrats (dividend stocks with 25+ years of consecutive dividend increases) despite its July 31st announcement of its 50th consecutive annual dividend increases.

On the surface, this does not make sense. There *should* be 25 years between a company inclusion in the Dividend Aristocrats and a company's inclusion in the Dividend Kings.

However, the Dividend Aristocrats is a stock market index maintained by S&P (while the Dividend Kings list is maintained independently). There are *additional* requirements to be a Dividend Aristocrat besides the 25 years of consecutive increases.

The *full* requirements to be a Dividend Aristocrat are:

Be in the S&P 500

Have 25+ consecutive years of dividend increases

Meet certain minimum size & liquidity requirements

You can see the full list of all 51 Dividend Aristocrats here.

Federal Realty became a member of the S&P 500 in early 2016, which is why the company only became a Dividend Aristocrat in 2017 (the index is updated annually).

Growth Prospects

Federal Realty Investment Trust's growth over the past several years has been robust. The company has compounded its funds from operations per share (which is the REIT equivalent of earnings-per-share and backs out non-cash depreciation charges) at a rate of 7.2% per year since 2012.

A Look Back
5 year history

	2012	2013	2014	2015	2016	
POI	$427	$447	$474	$511	$548	CAGR
Growth	*11.9%*	*4.7%*	*6.1%*	*7.7%*	*7.3%*	7.5%
FFO per Share	$4.31	$4.61	$4.94	$5.32	$5.65	CAGR
Growth	*7.7%*	*7.0%*	*7.2%*	*7.7%*	*6.2%*	7.2%
						Average
Dev, Redev & Investment	$195	$303	$396	$305	$456	$331
						Total
Acquisitions	$81	$87	$9	$154	$143	$474
Asset Sales	$0	$43	$10	$97	$0	$150
Net Debt to EBITDA	5.3x	5.3x	5.3x	5.4x	5.4x	
Fixed Charge Ratio	3.2x	3.4x	3.8x	4.3x	4.5x	

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Source: Federal Realty Investment Trust First Quarter 2017 Investor Presentation, slide 44

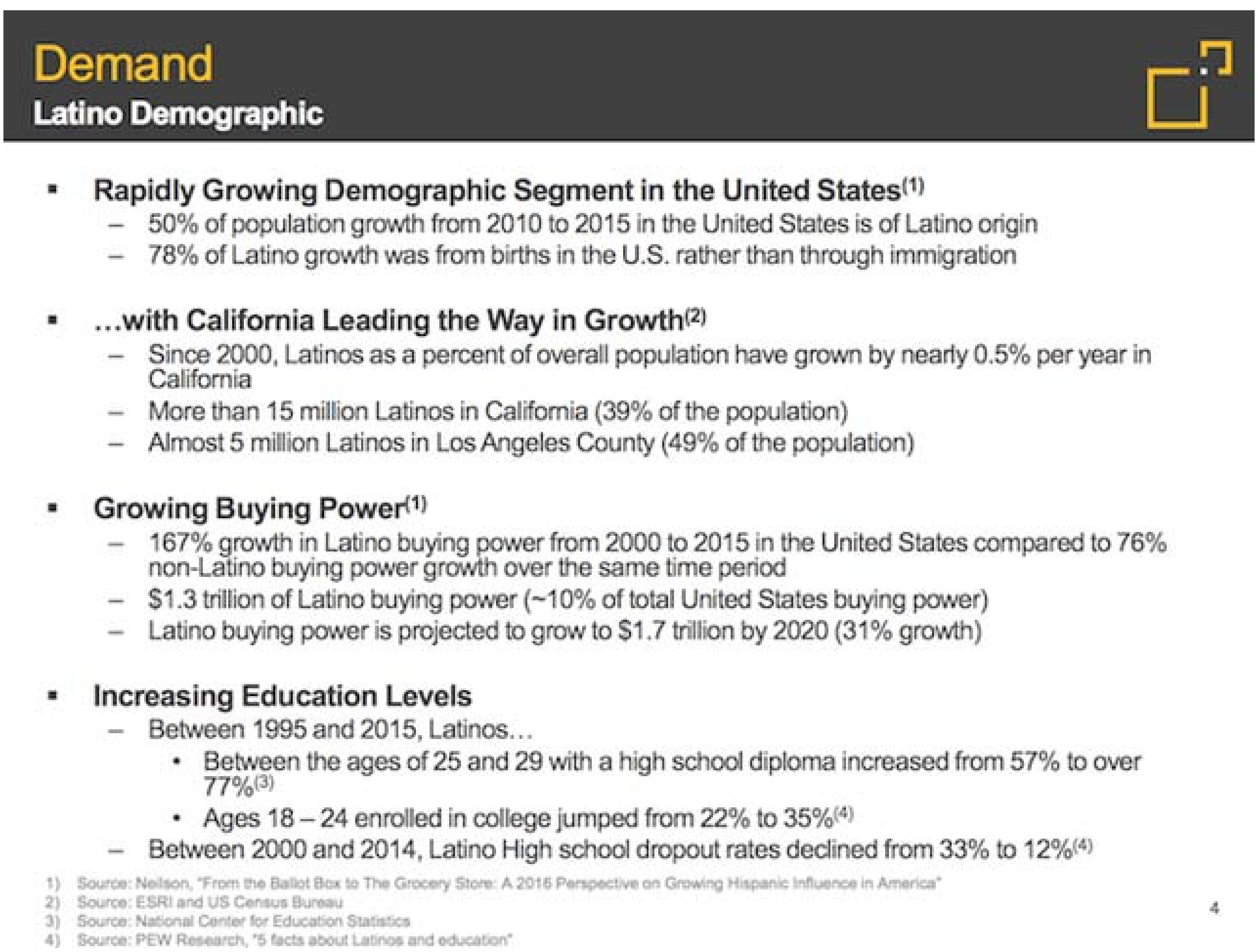
Looking ahead, Federal Realty's growth in the near-term will be driven by its recently-announced joint venture with Primestor Development Inc. that will see the venture acquire 7 properties in Southern California.

While 7 properties do not sound like much, keep in mind that the company owns and operates large mall locations, which means it owns much fewer properties than your typical REIT. For context, Federal Realty owned less than 100 properties at the time of its last earnings release – so 7 additional properties is a 7%+ increase from its existing asset base.

So why Southern California? The region has a number of interesting characteristics.

First of all, this region is notoriously 'under-malled' – it has a very low ratio of shopping square feet to population. This characteristic of high demand and low supply is something that Federal Realty actively pursues when executing acquisitions.

Southern California is also highly exposed to rising populations, particularly the Latino demographic.



Source: Federal Realty Investment Trust Primestor Joint Venture Presentation, slide 4

Rising populations will naturally lead to more shopping, benefitting Federal Realty's tenants and – by extension – the real estate trust itself.

The portfolio of properties being acquired has a number of notable characteristics. Each is at the intersection of major, heavily traveled vehicular arteries, which encourages walk-in traffic. In addition, they are located in densely-populated regions (another trait that Federal Realty actively pursues in acquisitions).

Portfolio Overview

Unmatched Density and Location

- Federal Realty has acquired an approximate 90% interest in a portfolio that includes 5 dominant community shopping centers, plus 1 center under redevelopment and a minority interest in a 7th shopping center
- All 7 properties are located at the intersection of major, heavily travelled vehicular arteries with average population within a 3-mile radius of 320,215
- The 6 stabilized properties are 98% occupied with ABR ~$21 and anchor ABR ~$15

Property	Location	SF	Acreage	Major Tenants
Azalea	Southgate, CA	222,000	22	Marshalls, Ross, CVS, Ulta
Bell Gardens	Bell Gardens, CA	327,000	29	Marshalls, Ross, Petco, Food 4 Less
La Alameda[2]	Walnut Park, CA	245,000	17	Marshalls, Ross, CVS, Petco
Olivo at Mission Hills[1] – *Under Redevelopment*	Mission Hills, CA	155,000	12	Pre-leased to: Target, 24 Hour Fitness, Ross
Plaza del Sol	South El Monte, CA	48,000	4	Marshalls, Starbucks
Plaza Pacoima	Pacoima, CA	204,000	18	Costco, Best Buy
Sylmar Town Center	Sylmar, CA	148,000	12	Food 4 Less, CVS
Total Primestor Acquisition		**1,349,000**	**114**	

1) Olivo at Mission Hills is currently under redevelopment, is 87% preleased and is expected to stabilize in late 2018
2) The joint venture has a 25% interest in La Alameda

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Source: Federal Realty Investment Trust Primestor Joint Venture Presentation, slide 8

The joint venture provides several new properties that Federal Realty can leverage to secure the trust's near-term growth. Federal Realty has a 90% interest in the venture, with the remainder presumably owned by Primestor.

Competitive Advantage & Recession Performance

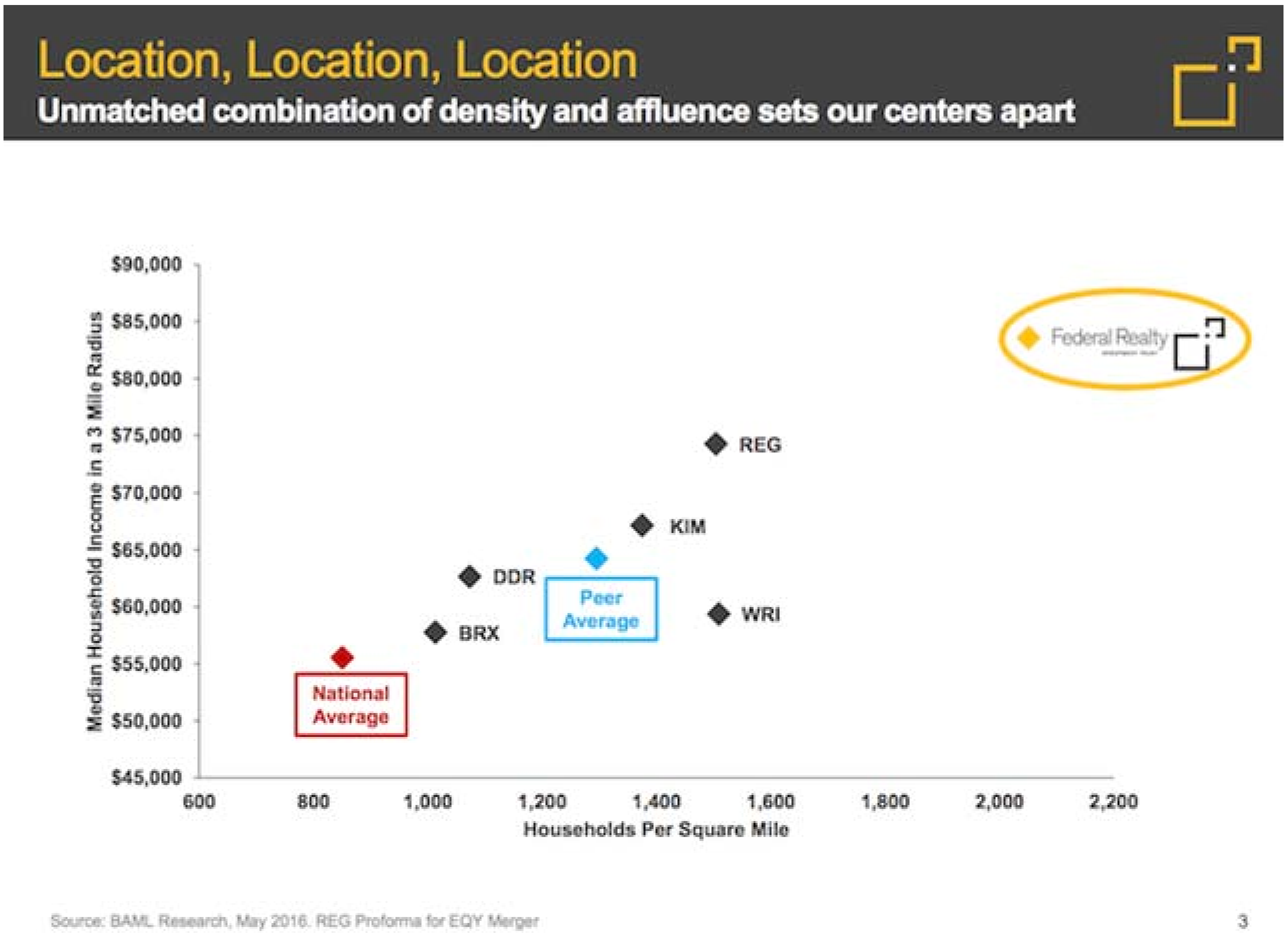
Like most REITs, Federal Realty attempts to create a competitive advantage through a high-quality portfolio of properties. The trust's long history of steadily rising dividends indicates that it has been successful so far.

So what does Federal Realty look for in new property investments?

There are two characteristics: population density and affluence.

Since Federal Realty owns malls, this makes sense: both factors (more shoppers and higher wealth per shopper) mean higher sales for its tenants.

Importantly, Federal Realty has built a portfolio that is superior by each of these metrics. On average, the trust's properties are located in high-income neighborhoods with high population density. This trend is shown below using a scatterplot.



Source: Federal Realty Investment Trust First Quarter 2017 Investor Presentation, slide 3

Federal Realty has historically performed *very* well during recessions. The trust's funds from operations per unit during the 2007-2009 financial crisis can be seen below:

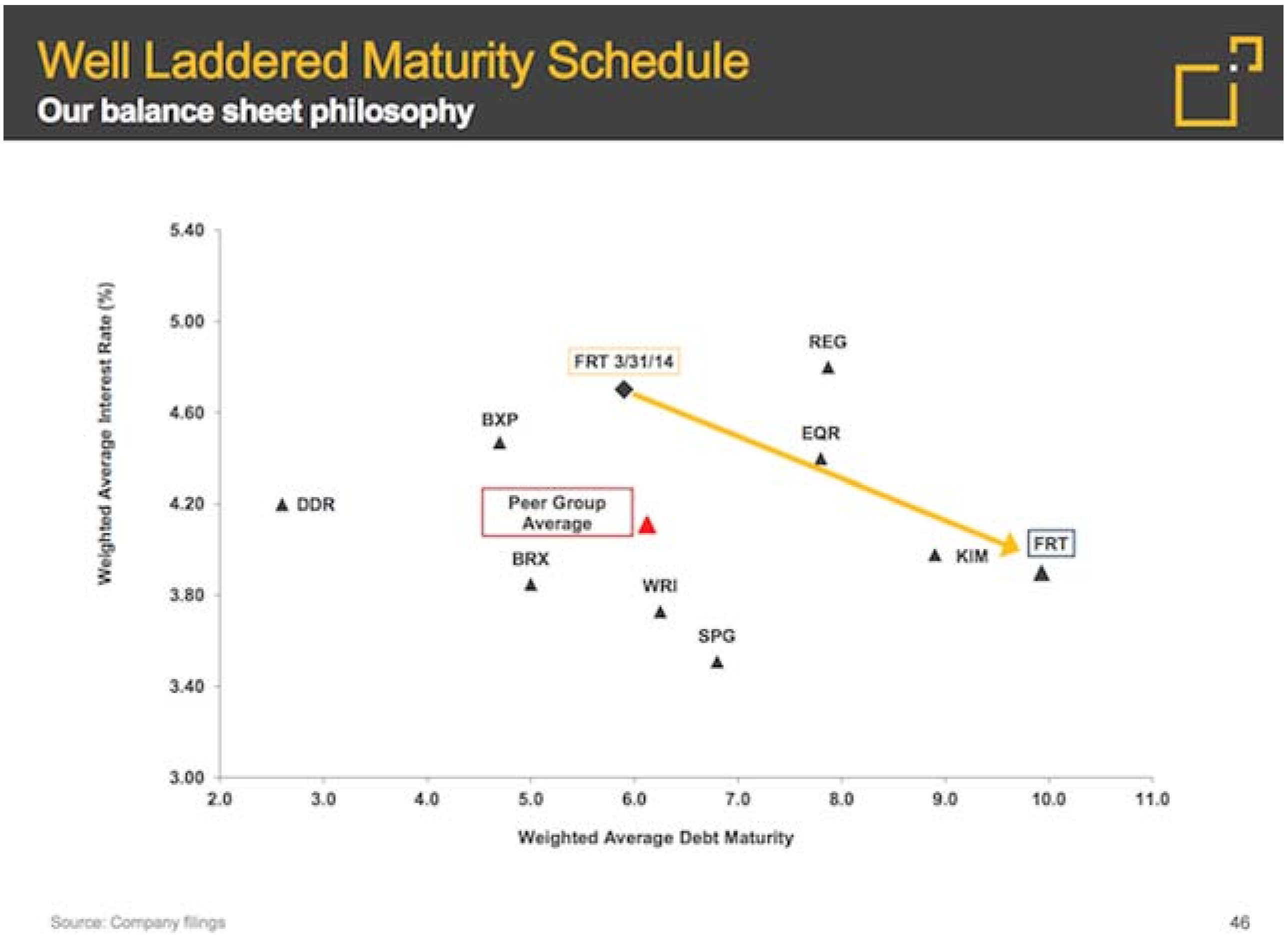
- 2007 funds from operations: $3.63
- 2008 funds from operations: $3.87
- 2009 funds from operations: $3.87
- 2010 funds from operations: $3.88

2011 funds from operations: $4.00

Amazingly, Federal Realty did not experience a single year of negative FFO growth during the financial crisis (although growth stalled completely from 2008 to 2009). This is a testament to the trust's competitive advantages and recession resiliency.

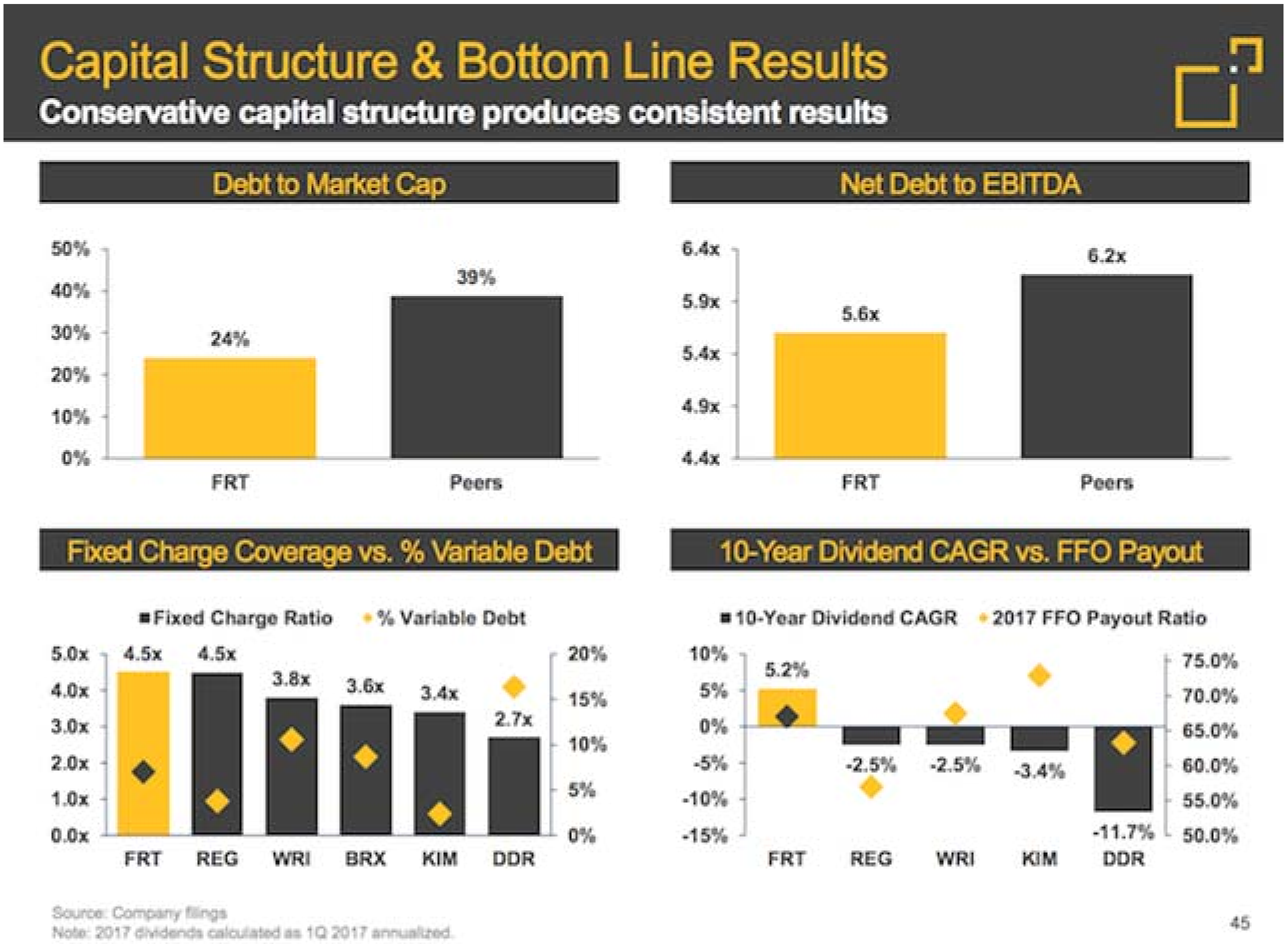
Looking ahead, Federal Realty is well-positioned to endure through future recessions because of its well-laddered debt maturity schedule.

The trust has a very long weighted average debt maturity, yet also pays a relatively low interest rate (below its peer group average).



Source: Federal Realty Investment Trust First Quarter 2017 Investor Presentation, slide 46

Additionally, the trust employs less leverage than its peer when measured by two important financial metrics: debt to market capitalization and net debt to EBITDA. Using either metric, Federal Realty is a more conservative investment than its REIT peer group.



Source: Federal Realty Investment Trust First Quarter 2017 Investor Presentation, slide 45

Federal Realty's historical recession performance and current financial positioning mean that is can reasonably be expected to outperform the broader REIT sector during periods of financial distress.

Valuation & Expected Total Returns

As a real estate investment trust, Federal Realty incurs significant non-cash depreciation and amortization charges which cause the company's GAAP net income to be significantly lower than its underlying cash flows.

This has two implications for investors: a REIT can *safely* pay out more than 100% of its net income as dividends, and REITs cannot be meaningfully analyzed using the traditional price-to-earnings ratio.

Instead of the P/E ratio, the easiest way to assess the valuation of a real estate trust is by comparing its current dividend yield to its long-term historical average.

Source: YCharts

In the past, Federal Realty Investment Trust traded at a dividend yield much higher than today's level. However, the markets eventually caught wind of this high-quality business, creating additional investor demand and driving its yield down. The REIT's yield since about 2005 has been much lower than its long-term average.

So how does today's valuation compare to recent history's?

Federal Realty's current dividend yield of 3.0% is between its 10-year average of 3.1% and its 5-year average of 2.7%. It appears that the trust is trading somewhere around fair value today.

As a result, the majority of Federal Realty's returns will come from its ~3% dividend yield and growth in its per-share funds from operations. Federal Realty has compounded this metric at a rate of 7.2% over the past 5 years, and I believe that long-term growth of 5% -7% is feasible over full economic cycles.

This gives a long-term total return expectation of 8%-10% for Federal Realty.

Final Thoughts

Federal Realty Investment Trust caught the eyes of many investors when it announced its

50th consecutive annual dividend increase on July 31st.

Some due diligence reveals that this REIT is trading near fair value and has some promising growth prospects thanks to its recent acquisition of a 90% interest in 7 properties in Southern California.

For these reasons, Federal Realty Investment Trust merits investment for those looking to bolster their real estate exposure. For more yield-hungry investors, better REIT investments lie elsewhere.

Disclosure: I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

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