



A Hidden Gem With a Big Dividend

Description

Real estate investment trusts (REITs) are known for their generous dividends. Then there's **American Hotel Income Properties REIT LP** ([TSX:HOT.UN](https://www.tsx.com/stocks/quotes/HOT.UN)), which stands out from the crowd. It offers a distribution yield at the high end of the yield spectrum—even for REITs.

American Hotel yields 7.9%! Is its yield sustainable? And how undervalued is its shares?

The business

American Hotel is a limited partnership that invests in hotel real estate properties in the United States. It primarily serves the rail crew accommodation, transportation-oriented, and select-service lodging sectors.

Although its hotels are mostly located in secondary and tertiary markets, they have high demand because they're in convenient locations that are close to railroads, airports, and highway interchanges.

The portfolio

In 2013 American Hotel had 32 hotels across 19 states. The company now has a portfolio of 80 hotels across 27 states.

On one hand, the REIT has 45 hotels serving the U.S. rail industry; it has long-term contracts with large rail companies in the U.S., including **Union Pacific**, BNSF, and **CSX**. The rail portfolio generates more than 40% of the REIT's net operating income.

On the other hand, the company has 35 hotels affiliated with leading national and international hotel brands, such as **Marriott**, **Hilton**, and **InterContinental Hotels Group**.

In September American Hotel announced the acquisition of four Marriott-branded hotels in Florida and Tennessee for US\$47 million; the deal is expected to close by November.

The REIT also announced the acquisition of two Embassy Suites by Hilton hotels in Dallas, Texas, and

Tempe, Arizona, in July.

Together, these acquisitions will bring the portfolio's hotel count to 86 with 8,022 guest rooms. Specifically, across 41 branded hotels, there will be 4,233 guest rooms, and across 45 rail hotels, there will be 3,789 guest rooms.

Valuation

Since American Hotel operates in the U.S., a strong U.S. dollar against the Canadian dollar benefits its earnings. While its funds from operations have been growing steadily in the last few years, its unit price hasn't moved much. In fact, it trades near its 2013 levels.

The units traded at a price to funds from operations (P/FFO) of about 13 in 2013. Today it trades at a P/FFO of 8.3. The units are significantly discounted given that American Hotel has a stronger and more diversified portfolio than before.

Juicy yield of 7.9%

American Hotel pays a U.S. dollar-denominated monthly distribution, totaling an annual payout of US\$0.648 per unit. This equates to a yield of nearly 7.9%.

Its payout ratio in the second quarter was 61%, which indicates a sustainable distribution with a safety margin.

Income tax on REIT distributions

REITs pay out distributions that are like dividends but are taxed differently. In non-registered accounts, the return of capital portion of the distribution is tax deferred until unitholders sell or their adjusted cost basis turns negative.

REIT distributions can also contain other income, capital gains, and foreign non-business income. Other income and foreign non-business income are taxed at your marginal tax rate, while capital gains are taxed at half your marginal tax rate.

When unsure of where best to hold REIT units, contact a tax professional or the REIT in question.

Conclusion

American Hotel's fundamentals are stronger than they were three years ago, as it will have expanded its portfolio from 32 hotels to 86 by November. Yet its share price has hardly budged from its 2013 levels.

With a payout ratio of only 61% last quarter and rising FFO per unit, American Hotel's juicy 7.9% yield is as safe as it has ever been. However, investors should note that the fluctuations of the U.S. dollar against the Canadian dollar will affect the effective income unitholders will receive.

CATEGORY

1. Dividend Stocks
2. Investing

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1. Editor's Choice

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Date

2025/08/10

Date Created

2016/10/11

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