Can These 2 REITs Maintain Their Big Dividend Yields?

Description

Many investors hold real estate investment trusts (REITs) for their high income. There's no doubt **American Hotel Income Properties REIT LP** (TSX:HOT.UN) and **Boardwalk REIT** (TSX:BEI.UN) offer above-average income of ~8.9% and ~5.6%, respectively, compared to the Canadian market (using **iShares S&P/TSX 60 Index Fund** as a proxy), which only offers a yield of ~2.8%.

Are the yields of American Hotel and Boardwalk sustainable?

American Hotel

American Hotel is a Canadian limited partnership which invests in hotels in the United States. Its portfolio is primarily comprised of branded, select-service hotels in large secondary markets. The company has long-term contracts with railway customers, which help stabilize its cash flow generation.

In early June, American Hotel raised gross proceeds of $200.9 million via an equity offering at $10.35 per unit. Management raised capital at a good time, seeing as the units have retreated almost 12% to $9.12.

The proceeds were used to grow its portfolio. They partially funded its acquisition of 18 Marriott and

Hilton select-service hotels located in Maryland, New Jersey, Pennsylvania, New York and Connecticut for a total purchase price of $395.0 million.

Despite the dilution from the equity offering, American Hotel had a payout ratio of ~85% in the second quarter (compared to the previous year’s 61%).

So, the company’s yield of ~8.9% looks sustainable, though it’d be nice to see the payout ratio reduce over time.

Additionally, American Hotel looks attractive as it trades near its 52-week low and a multiple of ~7.8. Interested investors should consider the stock in an RRSP or RRIF based on the fact that last year, a large portion of its distribution (62%) was taxable and likely U.S.-sourced income.

There has also been insider buying at about $9 per unit recently, which may indicate the stock has bottomed.

Boardwalk

Boardwalk hasn’t been doing well because of low energy prices. The residential REIT has ~60% and ~14% of its properties in Alberta and Saskatchewan, respectively.

The company’s funds from operations per unit declined 20% in 2016 and are estimated to fall another 25% this year. So, it’s not surprising that the stock has dropped 22% in the last 12 months. At this rate, its payout ratio won’t be sustainable this year.

However, management ownership of the stock is strong — more than 25% as of the most recent quarter, and the REIT maintains a conservative balance sheet with a debt-to-asset ratio of 44%. So, if it wanted to, the company can find ways to maintain its distribution, despite a stretched payout ratio.

Investor takeaway

At ~$40.10 per unit, Boardwalk offers a yield of ~5.6%. However, compared to American Hotel, the latter has a more sustainable yield. So, if you’re looking for safe income, consider American Hotel first.

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