Drive This 7.5% Yield All the Way to the Bank

Description

Two years ago, I highlighted a different kind of real estate investment trust (REIT) — one that owns the real estate on which car dealerships operate.

At the time, **Automotive Properties REIT** (TSX:APR.UN) owned more than 30 properties in Toronto, Vancouver, and other Canadian cities. The upside, I thought at the time, was the long-term leases it had with dealerships — an average of 13.6 years — providing significant net operating income to meet its annual dividend payout of $0.80 for a dividend yield of 7.3%.

The downside was that the Dilawri Group owned 38% of the REIT and generated 93% of the REITs net operating income. The success or failure of APR.UN was tied to this organization. It's never a good thing to rely on one customer or tenant for too much of your business.

What's happening in 2019?

Fast forward to May of this year.

Raymond James analyst Johann Rodrigues upped his projection for the REITs funds from operations (FFO) in 2019 and 2020 by a penny to $0.27 and $0.28, respectively. Rodrigues, who has an $11.50 price target and "outperform" rating on APR.UN stock also had a lot of good things to say about the company.

"With a host of recent acquisitions ($200-million-plus in the last 6 months), Auto Properties' leverage now sits at 56 per cent. We believe that the REIT could raise equity in conjunction with the next sizable acquisition, especially as the stock approaches NAV," *The Globe and Mail* reported May 17. "The one drawback to APR's strategy is that it is very equity-dependent; however, that equity is put to good use as most acquisitions are quite accretive to both FFO and NAV."

Two years ago, Automotive Properties had 30 properties. Today, it's up to 57 income-producing properties on 180 acres with more than two million square feet of gross leasable area. The Greater Toronto Area continues to be the biggest contributor of cash net operating income (CNOI) at 38% followed by Calgary (16%), Vancouver (14%), and Montreal (11%).

Mass-market dealerships account for 58% of its CNOI with luxury generating another 32% and ultra luxury accounting for the rest.

As the Raymond James analyst stated above, Automotive Properties make a lot of acquisitions. It's a big part of the REIT's growth strategy.

In March, it acquired two Winnipeg dealership properties from **AutoCanada**, one of the largest owners of car dealerships in the country, for $24 million. One was a **General Motors** dealership and the other **Volkswagen**.

Recently, Fool contributor Ambrose O'Callaghan cautioned investors about AutoCanada's stock, suggesting that the slowdown in Canadian car and truck sales would take a bite out of its share price.

Does the slowdown affect Automotive Properties?

It does and it doesn't.

The negative surrounding APR.UN stock is that investors reading missives about the struggling car and truck market will assume the worst when it comes to any auto-related business in Canada, whether we're talking about AutoCanada, **Linamar**, or Automotive Properties.

However, the reality is that unless a significant recession hits and dealerships are unable to pay their rent, APR.UN is still going to get paid, because dealerships need the property to carry on doing business.

With long-term leases of almost 14 years, Automotive Properties is as insulated as it can be. The more likely scenario to worry about would be higher interest rates lowering its CNOI, putting the monthly distribution in jeopardy.

In 2018, its adjusted funds from operations (AFFO) was 88.7% — 280 basis points lower than in 2017. In 2019 and 2020, AFFO is projected to be 85% and 82%, respectively, putting in line with some of Canada's largest REITs including **Choice Properties** and **Crombie REIT**.

Currently yielding 7.6% and trading at less than 11 times 2020 AFFO, Automotive Properties is one of the better value buys in the REIT world.

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