



Income Investors: Don't Depend on This REIT's Juicy 9% Yield

Description

In March 2019 **Slate Retail REIT's** (TSX:SRT.UN) stablemate **Slate Office REIT** announced that it was slashing its dividend by almost 50% as it repositioned its operations to strengthen its balance sheet and deliver value for investors. It appears that a similar cut could be on the way for Slate Retail.

A deteriorating outlook

The trust, which is paying a regular monthly distribution yielding over 9%, is being buffeted by the headwinds battering bricks and mortar retail as well as shopping malls. Slate Retail has reported a net loss for four out of the last five quarters, ratcheting up fears that a distribution cut is on its way.

Those significant quarterly losses mean that the trust has a negative payout ratio on a trailing 12-month basis, further magnifying fears of a cut.

Nonetheless, measuring the payout ratio of a REIT's distribution using net income is not the most appropriate methodology.

A superior measure to use is the proportion of a REIT funds from operations (FFO) that is distributed to unit holders. When using this approach, the ratio falls to a very sustainable 69%. While this is a common method for measuring whether a REIT can maintain its distribution, it's certainly far from ideal.

You see, the FFO doesn't include recurring capital expenditures, which are crucial to the business's operation like maintenance spending. That makes using adjusted funds from operations (AFFO) in the place of FFO a superior measure. After substituting Slate Retail's trailing 12-month AFFO to calculate the payout ratio, it rises to a worrying 104%, thereby indicating that the distribution isn't sustainable over the long term.

This is exacerbated by the [deteriorating outlook](#) for retail, which is not only weighing on Slate Retail's market value, but also its future earnings. Declining sales for bricks and mortar retailers, which has triggered a slew of bankruptcies and store closures, is hurting retail REITs. Meanwhile, Slate Retail has proven relatively resilient to current industry headwinds, and its outlook remains constrained. The

collapse of traditional bricks and mortar retail could be accelerated by [Trump's plans](#) to slap a 25% tariff on US\$300 million of imports from China, which would further impact Slate REITs earnings.

There are also pressures on the trust to reduce debt. Slate Retail is heavily levered, finishing Q1 2019 with almost US\$850 million of debt, which represents a worrying 61% of its gross book value (GBV). This emphasizes that Slate Retail needs to reduce debt, which is difficult given that the trust has little to no cash on hand and is only generating a moderate amount of free cash flow.

For these reasons, management chose to sell two North Carolina properties for US\$25 million in March 2019, the proceeds of which were used to dial-down debt. Slate Retail intends to make further dispositions to raise additional funds that can be directed to reducing debt to more manageable levels.

The divestment of additional properties will cause FFO, AFFO and net income to fall, causing Slate Retail's payout ratio to balloon out even further and increasing the likelihood that Slate Retail will reduce its distribution. Management could reduce the monthly payment by around 30%, giving FFO, AFFO and cash flow a solid boost while making the distribution far more sustainable while still be yielding a very juicy 6%.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:SGR.UN (Slate Retail REIT)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date

2025/07/02

Date Created

2019/06/04

Author

mattdsmith

default watermark