This 12.6% Dividend REIT Is the Ultimate Passive-Income Stock

Description

Real estate is an asset class that somehow manages to combine the steady returns of bonds with the price appreciation of stocks. This balance between growth and income makes properties perfectly well suited for any passive-income portfolio. Investing in real estate investment trusts (REITs) makes this asset class easily accessible for just about anyone.

However, Canada's market for REITs isn't as diverse as the one south of the border. The vast majority of the trusts listed on Toronto's stock exchange hold either commercial, industrial, or residential properties. There are no mortgage or data centre REITs in the country. This makes it difficult to diversify an income-oriented property portfolio.

In recent years, some new entrants have helped add colour to the market and provide more options for savvy investors. One such recent listing was **American Hotel Income Properties REIT** (TSX:HOT.UN). Listed in 2013, the REIT exclusively holds a basket of premium hotels across the United States. As of May 2019, the trust manages 18 brands across 112 hotels in over 32 American states.

Its portfolio of brands includes some familiar names such as Embassy Suites, Residence Inn, Hampton Inn, and Holiday Inn Express. The trust also has a long-term contract with railway operators to manage "economy lodging" facilities for railway crews along major railways stations.

According to the company's investor presentation, all of its properties were purchased below replacement cost, with an average trailing 8% capitalization rate, using long-term fixed-rate debt that averages 4.64%. Incidentally, the value of the trust's long-term debt is just 53.8% of gross book value, which is relatively low for a real estate firm.

Furthermore, 90% of the trust's funds from operations are paid out in the form of monthly dividends, with an effective annual yield of 12.67% at the time of writing.

In short, the trust has bought undervalued properties, maintained a sizable margin between its cost of debt and rental income rate, and signed long-term contracts that ensure reliable recurring income. AHIP should check all the boxes for income-seeking, risk-averse investors.

Despite its robust fundamentals, investors have pretty much overlooked the stock, and it has gradually lost value since its listing. Its current market price is more than a third lower than the day it listed. Part of the reason for this decline could be the expensive renovations and acquisitions the firm has been making in recent years.

However, savvy investors might appreciate the company's strategy of bolstering the portfolio and adding value to their properties. Hotels, after all, require tremendous upkeep, but well-maintained properties with premium branding could attract higher rates, ultimately resulting in better performance for shareholders.

Bottom line

AHIP's strategy of using long-term fixed-rate debt to expand a portfolio of premium hotels across the U.S. has helped the company expand rapidly over the past six years. However, investors have failed to recognize the trust's inherent value, which has deflated the market price of the stock.

At this point, AHIP offers one of the highest dividend yields on the Canadian market on a monthly basis, which makes it an ideal candidate for any passive-income portfolio.

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