2 Canadian REITs to Buy and 1 to Avoid

Description

Real Estate Investment Trusts (REITs) are known for their high yields that deliver healthy distributions to income investors. As investment trusts, they are required by law to pay out at a high percentage of taxable income to shareholders. It's for this reason that most REITs have high payout ratios.

All REITs however, are not created equal, and some are experiencing considerable pressure on their dividend. Case in point – **American Hotel Income Properties REIT** (TSX:HOT.UN).

American Hotel operates in two segments: Premium Branded Hotels and Economy Lodging Hotels. The Premium Brand segment consists of 67 hotels, while its Economy Lodging segment consists of 45 hotels.

The company has however, announced its intentions to sell its Economy Lodging segment for US$255 million. After taxes and mortgage repayments, the company will generate net proceeds of approximately US$90 million.

This makes American Hotel Properties a more focused company, and a pure play on premium brands such as Marriott and Hilton. The increased cash on hand and liquidity is a good thing for the company. Why? The distribution is under pressure.

American Hotel currently yields a hefty 12.4% and has a trailing 12-month (TTM), adjusted funds from operations (AFFO) payout ratio of 101.4%. It's also worth noting that AFFO decreased by 3.8% last quarter.

Unfortunately, this means that the company isn't generating enough cash to cover the high distribution. The company is undergoing significant renovations to its older properties.

It is a must-do amid this highly competitive market, and is a drag on cash flows. The headwinds facing the company are reflected in its share price which has lost 30% of its value over the past couple of years. At this point, American Hotel's yield brings additional risk.

For those defensive investors, consider **Granite REIT** (TSX:GRU.UN) and **Allied Properties REIT** (TSX:AP.UN

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Allied Properties owns 188 office buildings located in mainly large metropolitan Canadian cities. The majority of these buildings are Class I buildings — 19th and early 20th century building with exposed beams, brick walls and hardwood floors. These make for highly desirable office spaces supported by its healthy 96.2% occupancy rate.

Granite is focused on warehouse and logistics properties in North America and Europe. Under the leadership of its new CEO, it is focused on serving the e-commerce market which is in need of significant distribution and logistic centres.

Both REITs are Canadian Dividend Aristocrats and as such, have a reliable history of dividend growth. Allied Properties currently yield's 2.99% with a seven-year dividend growth steak. It's expected to raise dividends again next month.

Granite, which yields 4.23%, recently extended its dividend growth streak to nine years. It raised dividends by 5% along with strong third-quarter earnings last week. It has the industry's second-longest dividend growth streak on the **TSX Index**.

Speaking of strong results, Granite has grown AFFO by approximately 23% through the first nine months of the year. This has dropped its payout ratio in relation to AFFO to 81% and all but guarantees continued dividend growth.

Similarly, Allied Properties has grown AFFO by 22% over the same period and the payout ratio has dropped to 83%.

What these companies lack in yield, they make up for in performance. Year to date, both companies have delivered strong returns for shareholders. Granite's stock price is up 23.30% and Allied Properties shareholders have enjoyed a 21.29% return in 2019.

Foolish bottom line

Allied Properties and Granite are less risky investments than American Hotel Income Properties. They are growing AFFO at a double-digit pace and their distributions are well covered.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AP.UN (Allied Properties Real Estate Investment Trust)
2. TSX:GRT.UN (Granite Real Estate Investment Trust)
3. TSX:HOT.UN (American Hotel Income Properties REIT LP)

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