TFSA Investors: 2 Small-Cap Canadian REITs With High Yields up to 8.8%

Description

Small-cap stocks may not consistently outperform their large-cap counterparts, but there remains a strong value proposition in investing in well-positioned, small names in any sector, as these may still have more growth potential given their total addressable markets, and some of them may be better placed to cost effectively serve those small niches their larger peers can't efficiently target.

This phenomenon applies to the real estate sector, too.

While most large, popular, and well-covered Canadian real estate investment trusts (REITs) have soared in 2019, a few less-known names have lagged behind, and they continue to offer juicy income yields going into the next year.

Let's review just two of them today.

BTB REIT

BTB Real Estate Investment Trust (TSX:BTB.UN) is a diversified landlord that owns 66 properties with 5.7 million square feet of gross leasable area serving the retail, office, and industrial use functions.

The trust has a market capitalization of just $311 million today after a 15% capital gain this year, and units receive a $0.035 monthly payout for a juicy 8.4% annualized yield, which investors could quickly compound by opting into the offered distribution-reinvestment plan (DRIP), where they can get a 3% discount on the unit price by reinvesting their monthly paychecks into more units.

Just this last month, management was pleased to report an improvement in the trust's third-quarter payout ratio of recurring distributable income from 110.5% last year to 96.8%, and the decline in FFO payout rate from 123.2% to 97.2%, as most of the trust's important performance metrics significantly improved during the third quarter of this year.

Portfolio occupancy levels increased to 93.6% exit September (the highest in 10 solid years), as tenant-retention ratios improved to over 75% (from 49.6% in 2018), resulting in a strong 10.1% increase in same-property net operating income and better distribution coverage.

That said, BTB's debt level remains elevated at 61.4%. Although leverage is down from 63.5% last year, management has not much capacity to cheaply borrow new money to finance new developments and acquisitions. Substantial and dilutive equity raises may be the only option available for any future growth plans after an ongoing capital-recycling program is completed.

Slate Retail REIT

Slate Retail Real Estate Investment Trust (TSX:SRT.UN) owns U.S. grocery-anchored real estate assets located in 50 metro markets.

Units have risen in price by 10% so far this year, and they offer a juicy 8.78% annualized distribution yield today, and investors could expect the payout to grow if management sticks to its annual payout increases, which saw the monthly distribution being hiked for the sixth consecutive year recently.

Investors have largely shunned the retail sector due to a negative sentiment that predicts the death of the brick-and-mortar grocery-anchored shopping mall from ruthless competition powered by online retailers the likes of **Amazon.com** and amplified by an innovative **Shopify**.

There is a growing shortage of retail space to let out in Slate's focus locations, and the trust managed to renew expiring leases at a 5.6% premium to the old rates, while new leases were signed at a 15.1% premium to average in-place rent during the last quarter.

Given a strong 95% tenant-retention rate that strengthens portfolio occupancy stability, and a funded property redevelopment program underway, the trust's distribution could remain safe and well covered, given the 84.4% adjusted FFO payout rate exit the third quarter of this year.

Investors could sleep well at night holding this small cap, while the power of compounding grows their nest egg without any effort on their part.

That said, the debt ratio was much higher than average at 59.7% of gross book value in September, but management is looking to redeploy over US$84 million generated from recent dispositions into new and better-earning acquisitions.

There's a huge high-yield income potential here, and the distribution seems well covered to offer some reasonable safety. However, management needs to redeploy funds from recent property dispositions quickly to maintain cash flow generation potential.

Bottom line

Both BTB and SRT offer higher than average distribution yields today, but units haven't soared as high as the broader index has done this year for good reason. They both carry some capital risks, and debt levels are at the high end of regulatory limits. The high yields are a good compensation for the risk assumed.

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