



Income Investors: \$50,004 in This REIT Pays \$500/Month

Description

Investors looking for a dependable source of passive income should look no further than a collection of Canada's finest real estate investment trusts (REITs).

These securities offer instant diversification, smart management teams filled with some of the best minds in finance, exposure to parts of the sector a retail investor normally can't access, and, perhaps best of all, a fully passive income stream. Your local landlord has dependable income from his rentals too, but he's likely [putting a lot of work into these units](#).

REITs can also offer some succulent yields, with payouts sometimes even surpassing 10% annually. Such high yields are on the riskier side, meaning investors should be careful and make sure they diversify. A [dividend cut](#) is never a good thing. It's devastating if you have all your eggs in one basket.

Let's take a closer look at one particular REIT, a company that pays out an eye-popping 12.2% annual dividend. That's enough to turn an initial investment of just over \$50,000 into a passive income stream of \$500 per month.

A unique asset

American Hotel Income Properties ([TSX:HOT.UN](#)) owns mid-range hotels across the United States. The portfolio consists of 79 different hotels, all owned in so-called secondary markets, places like Charlotte, Pittsburgh, and Jacksonville. These cities offer a combination of good returns and potential population growth.

The company has been transforming the portfolio lately, punting its budget hotel business for nicer assets. It got US\$215 million for the budget hotel assets and spent most of that cash to acquire 12 new premium-branded hotels.

The good news for investors is the budget hotels were sold for a cap rate of approximately 6%, while the new assets should earn around 8%. However, many of the budget hotels had contracts with rail crews, providing steady revenue no matter what the state of the underlying economy. The new assets

will be more volatile during tough periods.

Results have been somewhat weaker lately, primarily driven down by a renovation program hitting the bottom line. The company spent US\$14 million on renovations in 2018 and US\$25 million in 2019. The good news is no substantial projects are planned for 2020, which should make the dividend more sustainable.

Over its last 12 months, American Hotel Properties has earned US\$0.71 per unit in funds from operations, which most investors use as a substitute for net earnings for a REIT. It pays out a dividend of US\$0.648 annually, giving us a payout ratio of 91%, which is acceptable.

But as we all know, investing is about looking forward. The company's management has an interesting outlook, telling investors in a recent presentation that the forward payout ratio should be under 75% of funds from operations.

The big difference is because the renovation program is largely over, and the newly acquired hotels should add to the bottom line.

Collect \$500 per month

American Hotel Properties has a massive yield. The current payout is 12.2%. Although I believe the payout can be maintained, it's obvious at least some investors disagree with me.

Such a high payout translates into impressive passive income without having to contribute loads of capital. In fact, you can create a meaningful passive income stream with this stock for just over \$50,000.

It would take just 7,123 shares to generate \$500 per month, an investment that would set you back \$50,004 plus any applicable trading commissions. That's a serious amount of passive income — all for less than what it takes to buy a nice new car.

The bottom line

American Hotel Properties is more of a speculative dividend. There's no doubt about that.

But if management can bring that payout ratio down, this investment could turn into a real winner. Add that to the return potential from the dividend alone and we have a very compelling opportunity today.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:HOT.UN (American Hotel Income Properties REIT LP)

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