Canadian REITs: Are Dividends Safe?

Description

Amid the current environment, Canadian REITs are struggling to maintain distributions. COVID-19 mitigation efforts have all but sent the economy to a grinding halt. These measures, which are necessary to flatten the COVID-19 curve, are negatively impacting REITs.

Whether they be industrial, retail, office or industrial REITs, none are immune. The **S&P/TSX Capped Real Estate Index** is down 33% thus far in 2020, trailing the **TSX** by 300 basis points.

Earlier this week, I warned investors of two Canadian REITs with the potential to either cut or suspend distributions. It is rare to see real estate companies cut the distribution.

Why do I think REITs are at risk? The trend has already begun.

The first REIT to suspend distributions

The travel and tourism industry is among those feeling it the most. International travel is off limits, and in several cases, so too is cross-country travel. To flatten the curve, Canadians must stay home.

It is therefore not surprising that **American Hotel Properties REIT** (HOT.UN) was the first REIT to announce a distribution change. The company first cut the dividend by 30%, subsequently announcing that it was suspending the dividend until further notice.

Although all 79 properties remain open, "….recent deteriorating demand across the hotel sector which is expected to continue to negatively impact future guest bookings and occupancy levels at AHIP's properties.'

This Canadian REIT is among the worst performing in the sector. Year to date, American Hotel Properties is down by 76%, more than double the S&P/TSX Real Estate Index.

On the bright side, expect AHIP to rebound in a big way once travel resumes. The dividend is also likely to be reinstated once this happens. However, investors are best to keep expectations in check. A return to pre-COVID-19 levels is unlikely in the near term. A return to a semblance of normalcy will take months, if not longer.

A Western Canadian REIT

Certain companies are facing two headwinds: COVID-19 and low oil prices. **Melcor REIT** (TSX:MR.UN) is one such company. Melcor acquires, manages and leases commercial property in Western Canada.

In mid-March, this Canadian REIT reduced the monthly distribution to $0.03 per share, a 47% cut. Furthermore, Melcor also reduced wages at the executive level, and laid off approximately 25% of its staff.

According to the company the cut will “improve (their) ability to manage the potential for a sudden reduction in the amount of rent (they) are able to collect.”

The company’s pre-cut distribution payout ratio of 112% should have been a warning sign. In the best of times, this can be difficult to maintain. Similarly, the company is highly leveraged with a debt-to-equity (D/E) ratio of 156%, which is well above the industry average (~90%).

Depending on how long this persists, it’s possible that a further cut or dividend suspension is on the way.

Foolish Takeaway

Despite low interest rates, the low price of oil and COVID-19 measures are having an unprecedented impact on the sector, and so more cuts or suspensions are likely on the way.

To avoid distribution cuts, stick with those that have low payout ratios and conservative debt profiles.

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