Real Estate: 2 Small-Cap Income-Generating Stocks to Buy Now

Description

The stock market remains volatile as the U.S. Federal Reserve maintains a hawkish stance on interest rates. Fed officials are supporting a 0.75 percentage point hike at the September 20-21 policy meeting, which has created a sell-off in higher-risk, small-cap stocks. Risk-averse investors generally limit exposure to small-caps, as they are extremely volatile in the short-term. But if you pick the right stocks, small-caps could outperform in the long-term as they grow their business and market share.

How much should you invest in small-cap stocks?

As small-caps are higher risk, I suggest aiming for minor exposure to these stocks. If it's your first time investing in small-caps, consider investing an amount that won't affect your expenses and goal-based investments.

If you have $500 to invest in your Tax-Free Savings Account (TFSA), here are two small-cap stocks trading below $7 a share with an attractive annual dividend yield of over 5%.

Slate Office REIT

Real estate in a prime location generates ample rent. **Slate Office REIT** (TSX:SOT.UN) is a small-cap REIT with over a $380 million market cap and a $2 billion asset portfolio. Its portfolio comprises 55 commercial properties in Canada, the United States, and Ireland.

To analyze a REIT, look at its tenant base, occupancy rate, location, rental spreads, average lease term, and distribution history. 67% of Slate's tenant base is government and high credit ranking companies, and it has an occupancy ratio of 83.6%. These figures are relatively lower than bigger REITs that have 75%+ creditworthy tenants and over 90% occupancy.

Slate carries the risk of lower occupancy, but also the opportunity to fill more vacant offices and increase cash flows. It aims to grow by acquiring assets at a discount and creating value by finding high credit rating tenants and longer lease terms. Slate Office REIT's stock price dipped 14% since

March 2022, when the Fed announced its first interest rate hike after the pandemic. The stock could continue to fall as long as the Fed continues to hike interest rates.

This REIT is using the dip to make acquisitions as property prices are easing. Its stock price could bounce back when the economy recovers. A $250 to $300 investment in this small-cap stock is a risk worth taking.

Bird Construction stock

Infrastructure company **Bird Construction**'s (TSX:BDT) stock slipped 37% from its November 2021 high as the overall market slid downhill. It's a small-cap company with a $357.6 million market cap and $2.3 billion in annual revenue.

It builds, repairs, operates, and maintains industrial, commercial, and institutional projects. It has a backlog of $2.9 billion worth of projects, of which it expects to convert 57% into revenue in the next 12 months. While new construction drives revenue growth, industrial service contracts generate regular cash flows and allow Bird to pay dividends. Bird has $800 million in service contracts with a three to five-year average term.

The company pays its dividends monthly and has a juicy annual dividend yield of 5.8%. But BDT is a high-risk stock because it's paying 275% of free cash flows as dividends, which is not sustainable and could lead to dividend cuts if its fundamentals don't improve.

The company has been diversifying risk by increasing exposure to low-to-medium risk projects. Its stock could surge 30-40% to over $9 in an economic recovery but fall to $5 if there is a dividend cut. However, considering the mix of new construction projects, a diversified approach to risk, and industrial service contracts, this stock could thrive in a recession and compensate for the dividend cut with capital appreciation.

How to add small-caps to your portfolio

Small-caps outperform in a strong economy but are risky because they haven't been stress tested. So, it makes sense to allocate a significant portion of your investment portfolio to large-cap stocks, ETFs, and mutual funds. For now, consider setting aside 3-5% of your portfolio for investing in a new asset class or stock type. As you continue to learn and gain confidence as an investor, you can grow your exposure to risky stocks to 5-7%. But be sure to always have a backup plan if speculative bets falter.

CATEGORY

1. Dividend Stocks
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TICKERS GLOBAL

1. TSX:BDT (Bird Construction Inc.)
2. TSX:RPR.UN (Ravelin Properties REIT)

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