Danger Ahead: Are Dividend Cuts on the Horizon for These Underperforming REITs?

Description

REITs are popular with income-seeking investors due to their required payout minimums, high yields, and diversification across a broad range of real estate assets. However, just like any other investment, a REIT's payout is only as good as the underlying business mechanics and its balance sheet. Below are three REITs that offer generous dividends, but come with dangerously high debt levels.

Northview Apartment REIT (TSX:NVU.UN) is currently paying out a yield of 8%, or 79.6% of its funds from operations (FFO), while trying to manage a debt load that is 14 times EBITDA and 60.2% of its gross book value; compare this to 51.3% in Q2 2015. Northview's latest earnings report was a disaster as the REIT's heavy exposure to Alberta dragged down same property net operating income by an incredible 11% year over year, even after accounting for the wildfires.

That being said, to its credit, Northview is expected to close on a $79 million disposition of non-core assets in Q3, which should reduce its debt-to-gross book value by .9%.

Artis Real Estate Investment Trust (TSX:AX.UN) is another highly levered (8.4 times EBITDA; 52.9% of gross book value versus 49% in Q2 2015) Alberta play with a payout ratio of 71% of its FFO; it also has 84.4% of adjusted funds from operations (AFFO). Also, much like Northview, Artis was hit hard from the economic downturn. Calgary office NOI fell by 13.9% in Q2 of this year compared to Q2 2015.

Furthermore, Artis took a fair-value write-down of $21.6 million on investment properties in Q2, even as it looks to shed underperforming properties to generate some much-needed cash. However, don't expect management to use the proceeds of the property sales to delever its balance sheet, as the company has made clear its intentions to continue expanding into the U.S.

Cominar Real Estate Investment Trust (TSX:CUF.UN) has the lowest exposure to western Canada, but that doesn't mean its balance sheet has fared much better. This primarily Quebec-based commercial REIT pays out over 100% of its AFFO. It has a net-debt-to-fair-market-value-of-assets ratio of 54.4% (versus 54.6% in Q3 of last year). In Q2 of this year, Cominar reported across-the-board negative NOI growth for its office, retail, and industrial/mixed-used segments (-2.4%, -.8%, and -3.5%, respectively) even as occupancy rates ticked upwards.

Finally, one of Cominar’s largest tenants, **Bank of Nova Scotia,** will not be renewing its lease of Scotia Centre in Calgary and will take with it roughly .5% of Cominar’s rental revenues. To Cominar’s credit, however, it has managed to shed over $210 million of non-core assets in 2015 and recently completed a $200 million equity raise to aid in its deleveraging efforts.

The bottom line

Not all REITS are equal as the aforementioned three have shown. Although they pay high yields, it remains to be seen just how sustainable their payouts will be in the face of continued weakness in the Canadian (namely Albertan) economy. On the flip side, they are trading at significant discounts to their net asset values (NAV), so if you can tolerate the risk, what’s a little debt overhang for some really juicy yields?

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