7 Reasons to Never Buy Rental Properties

Description

Real estate is a great business…

These nice companies called banks lend you all the money you need to invest. Then these wonderful people called tenants pay off your mortgage.

It's no wonder thousands of Canadians want to try their hands in the landlord business every year. But there's a far easier (and more lucrative) way to invest in this asset class: real estate investment trusts.

REITs are like real estate mutual funds, buying and selling investment properties on behalf of their investors. And while this is a hotly debated topic on the internet, they are a far better investment option for most people. Here are seven reasons to skip rental properties entirely and buy REITs instead.

1. Less hassle

Imagine spending your 'golden years' chasing down rent cheques, screening renters, and collecting security deposits. Residents call you in the middle of the night complaining that the toilet is clogged again. You spend hot summers stuck outside mowing lawns where the humidity is so thick you could cut a knife through it. Ugh!

Being a landlord is a hassle. But there are no such issues with REITs. A professional management team handles all of the day-to-day business operations. You just have to sit back and watch the distribution cheques roll in every month.

2. Too slow

With REITs you can start collecting annualized yields as high as 5%… 7%… even 9% on your investment as early as next month. Good luck buying and renting out a house that quickly. Few rental deals generate positive cash flow right out of the gate.

3. High transaction costs

Realtors will cost you 2% to 3% of the property's value. And don't forget the cost of lawyers, title insurance, transfer taxes, and sleep aids (buying a house is stressful!). Immediately after you purchase an investment property, you're already down 7% to 10%.

When you buy or sell a REIT, you pay small brokerage commission. And just like any regular stock, there's a bid/ask spread. This will rarely cost more than 0.25% of your investment except for the most illiquid of REITs.

4. No liquidity

Rental properties are time-consuming to sell. There's the hassle of finding a realtor and negotiating deals. If you need to raise cash fast, you're out of luck.

REITs, in contrast, can be bought and sold with the click of a mouse. In my experience, the transaction is completed faster than I can refresh my computer screen.

5. No diversification

A rental property is a giant bet on one neighbourhood, in one city, in one province, in one country. REITs provide instant diversification.

Consider Canada's largest publicly traded trust **RioCan REIT** (TSX: REI.UN), which owns 330 retail properties totaling over 79 million square feet of space across North America. The company's tenants include high-quality corporations like **Canadian Tire**, **Walmart**, and **Shoppers Drug Mart**. These are far more credit-worthy residents than the friendly people answering ads on Kijiji.

For those of you who don't want to dig through financial statements, I recommend the **iShares S&P/TSX REIT Index Fund** (TSX: XRE). This fund owns over a dozen of the country's top REITs. Best of all, investors can quickly diversify across property types and geographies.

6. Costs

You need at least a $25,000 down payment to break into the real estate business. Even then, you would probably want thousands of dollars in reserve just in case any problems come up. You can start buying REITs with as little as $20.

7. Leverage

Contrary to popular belief, rental properties aren't the only place you can exploit the power of leverage. Most REITs will borrow $2… $3… even $4 of debt for every $1 of equity they have on their books. You can dial up your leverage further by buying trusts on margin or purchasing call options.

That said, debt is no magic bullet. Higher leverage also means higher risk. History shows that excessive debt can lead to catastrophic losses.

What your real estate agent won't tell you

Imagine if a financial advisor recommended investing most of your retirement savings in a shaky penny stock with a $500,000 market capitalization? They would lose their license immediately!

Yet this proposition is the same as owning individual rental properties. It's far more prudent to own larger, professionally managed businesses like REITs.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:REI.UN (RioCan Real Estate Investment Trust)
2. TSX:XRE (iShares S&P/TSX Capped REIT Index ETF)

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