3 Reasons to Never Buy Rental Property, and 2 REITs to Buy Instead

Description

It’s a tough business being a landlord, especially in Toronto and Vancouver, Canada’s two largest markets.

Essentially, there are three gigantic risks for investors looking to buy physical rentals.

1. The real estate market is at record highs, and many investors are getting terrible cash flows. When an investor can’t even show a profit without needing price appreciation, they’re doing it wrong. Where’s the margin of safety? What if they can’t sell the property because the market slows down? It’s a very risky situation to depend on the value of something as illiquid as real estate, especially considering how much it costs to sell.

2. If an investor only has one or two units, they’re putting a lot of eggs into one basket. If you own a portfolio with 25 stocks in it and one stops paying its dividend, you’re looking at a minor inconvenience. Buy if you own one rental property and you have a tenant behind on the rent, that’s 100% of cash flow you’re missing out on. The lack of diversification is downright scary.

3. And if the lack of diversification isn’t scary enough, think about how leverage can go against you. Imagine putting down 10% on a unit worth $300,000. If the unit falls 15%, you’ve not only lost your entire down payment, but you’ve also lost an additional $15,000. At least when you buy a stock, the most you can lose is your principal, and even that’s exceedingly unlikely.

Especially at this point in the cycle, buying physical real estate is just a bad idea. Instead, investors should take a look at these two REITs. They’re a much better value than a rental property, and all they’ll need to do is cash their “rent” cheques. No chasing tenants or plumbing repairs required.

Dream Office REIT

Dream Office REIT (TSX: D.UN) is one of Canada's largest owners of office buildings, with more than 60% of its 182 locations located in Toronto and Calgary. Both cities are popular with developers, which has added to supply over the last year. Dream's occupancy rate has dipped as a result, from morethan 95% to just over 94%.

But investors with a long-term view shouldn't worry. Calgary and Toronto are still going to be very important markets going forward, and Dream has some of the finest assets in each city. Shares also trade at a significant discount to book value, and offer a very attractive 7.9% yield.

Good luck finding an investment property that'll give you that kind of cash flow.

RioCan Real Estate Investment Trust

Not only is **RioCan Real Estate Investment Trust** (TSX: REI.UN) Canada's largest REIT, but it also offers an interesting potential opportunity.

The company continues to both buy existing property and develop its own in order to grow. What it's discovered is that if it adds a residential component to a retail complex, the cost of the residential part of it is significantly less than a standalone building. That's because a big portion of the development's cost is in the land and improvements to it, like adding parking or installing water and sewer systems, which is a cost it already has to bear.

It currently has two of these hybrid residential/retail developments in the pipeline. Whether the company keeps the residential part or decides to sell it, investors will benefit. This is a nice bonus for a company that may start to feel the pinch from consumers migrating to buying more things online.

RioCan's shares currently yield a respectable 5.4%, and its payout ratio is under 75%. It might be time to buy the company now, before it increases its distribution.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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2. TSX:REI.UN (RioCan Real Estate Investment Trust)

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