7 Reasons Why REITs Beat Rental Properties

Description

It's one of the most popular investments around… owning rental properties.

You collect rent each month and every year your property values go up. Some people even *retire* on the money generated from their real estate!

But owning a rental is no walk in the park. There are chores like unclogging toilets and mowing lawns, not to mention the hassle of chasing down rent cheques from tenants.

At least, that's how things used to be. But there's another way to earn steady, monthly income through rental properties *without* becoming a landlord — real estate investment trusts, or REITs.

In essence, you can think of a REIT like a real estate mutual fund. These businesses buy properties, collect rents from tenants, and pass on the income to investors. And because of how they're legally structured, REITs pay no corporate taxes.

For most, blue-chip trusts such as **H&R REIT** (TSX:HR.UN), **Boardwalk REIT** (TSX:BEI.UN), and **Dream Office REIT** (TSX:D.UN) are a compelling alternative to owning real estate directly. Here are seven reasons to skip rental properties altogether and buy REITs instead.

1. Lower startup costs

You need at least a $25,000 down payment to break into the real estate business. In addition, you'll want thousands of dollars in reserve to cover vacancies and other surprise expenses. With REITs, however, you can get started with as little as $20.

2. Instant cash flow

Because many REITs receive rents from tenants monthly, it only makes sense for them to pay their unitholders in the same fashion. That means you can begin collecting yields as high as 5%, 7%, even 10% almost immediately. But unless you pay for your property without a mortgage, few rentals are cash flow positive right out of the gate.

3. Less expensive

You usually have to pay a small commission each time you buy or sell a REIT. This will cost about $10 to $20 at most discount brokerages.

Property transactions are much more expensive. There's the cost of lawyers, title insurance, and transfer taxes. Realtors will charge 2% to 3% of the property's value. After you purchase a rental, you're immediately down 8% to 10% on your investment.

4. Better liquidity

REITs can be bought and sold just like a stock. Typically, the transaction is completed faster than you can refresh your computer screen.

Rental properties, in contrast, can take months to sell. There's the hassle of finding an agent and negotiating the deal. If you need cash fast, be prepared to take a big haircut on your investment.

5. Less hassle

Picture spending your 'golden years' screening renters, collecting security deposits, and chasing down rent cheques. *No thanks!*

With REITs, a professional management team handles all of the daily operations. You just have to sit back and wait for the cheques to roll in.

6. Better diversification

Most landlords only have the resources to buy a few rentals. But with REITs, you can instantly diversify your portfolio across thousands of properties, in dozens of geographies, and several property types. For me at least, that makes it easier to sleep at night.

7. More leverage

Rental properties aren't the only place where you can exploit leverage. Some REITs borrow up to $5 in debt for every $1 of equity they have on their books. You can dial up your leverage further by buying trusts on margin or with call options. Of course, I don't recommend this.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BEI.UN (Boardwalk Real Estate Investment Trust)
2. TSX:D.UN (Dream Office Real Estate Investment Trust)
3. TSX:HR.UN (H&R Real Estate Investment Trust)

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