Why I'm Buying These 3 REITs Instead of Rental Houses

Description

Just over a decade ago, I was all about buying rental properties.

I wasn't in love with managing them myself, but returns of over 10% before taxes–plus potential capital appreciation–made active management relatively attractive. I also liked the ability to leverage these properties using only a small amount of my own capital, as well as the ability to take nice write-offs when doing my taxes.

Things have sure changed over the last 10 years though. Properties that offered cap rates of between 10% and 15% have now been bid up, so cap rates of between 4% and 6% are common. Sure, mortgage interest has gone down, but every other major expense has gone up. What was once a very attractive investment just doesn't excite me very much anymore, especially if you add in the active management aspect to it.

It doesn't help that investors are getting a terrific deal on some of Canada's biggest real estate investment trusts. Why would I pay inflated prices for commercial real estate when I can buy office space through a REIT at discounts of up to 40% of book value? Plus, I'm getting truly passive yields from these investments that I can't get from buying physical real estate.

To me, this is a no-brainer. Here are three REITs I like far more than any specific rental property.

Dream Office

Dream Office Real Estate Investment Trst (TSX:D.UN) is Canada's largest pure-play owner of office real estate, owning more than 22 million square feet spread throughout 160 properties located across Canada.

The problem, at least lately, has been Dream's exposure to western Canada. Some 25% of its net operating income comes from Calgary and Edmonton, two markets that are really hurting today. It's been mostly weakness in these two markets that have pushed the company's occupancy below 90% and forced a 33% cut in the dividend.

Over the next six to 12 months, it's easy to see additional weakness in Alberta. But for investors with a long-term time horizon, Dream's assets are selling at a very cheap valuation. The company has a net asset value of more than $30 per unit, yet investors can pick up shares today at $18.65 each. That's a discount of nearly 40%.

Even after cutting its distribution, Dream still offers investors a yield of 8.04%. The dividend is safe too with a payout ratio of just 65% of funds from operations.

H&R

H&R Real Estate Investment Trust (TSX:HR.UN) is a diverse owner of real estate, owning 40 office properties, 159 retail properties, eight residential properties and three development projects. Together, these assets are worth some $13 billion and cover 44 million square feet. Additionally, H&R owns 33.6% of Echo Realty, which has 207 properties in the United States.

Like Dream, H&R sells at a discount to book value. As of March 31, H&R had a book value of $23.83 per share, while shares currently trade hands at $22.15. Additionally, H&R pays a nice dividend of 6.1% with a recent payout ratio of just 68% of funds from operations.

H&R also is a 50% owner of a huge residential development project in Long Island City in New York, a US$1.2 billion project that is slated to start generating revenue in late 2017. This should provide a nice boost to earnings.

Automotive Properties

Automotive Properties Real Est Invt TR (TSX:APR.UN) is a relatively new Canadian REIT trading on the TSX for just under a year. It's the owner of 29 car dealerships across Canada with its primary tenant being the Dilawri Group, Canada's largest owner of automotive dealerships. Dilawri is privately held.

Automotive Properties offers investors a unique opportunity to participate in the consolidation of car dealerships across Canada. Companies like Dilawri are buying up dealerships owned by individuals who are looking to get out of the business. Dilawri can then free up capital by flipping the real estate to this REIT, which allows it to be more aggressive than peers who keep the real estate on their balance sheet.

Investors are also getting paid nicely to wait while participating in this unique growth story. Shares pay a dividend of $0.067 per month, which is good enough for an 8.04% yield.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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

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