The Easy Way to Build Your Own Real Estate Empire

Description

Many investors dream of building their own real estate empire. After all, it's been an almost foolproof way to get rich, especially as values in Canada's major cities keep going up. All someone needed to do was show up, invest, and go along for the ride.

But governments across Canada are taking steps to deflate what they view as a massive real estate bubble. Yields are anemic around the country, buoyed by low interest rates, interest in the sector, and ever-expanding personal debt levels. These are not the conditions I want when putting my hard-earned money to work.

Fortunately, there's a much easier way. It lets investors use leverage to build a completely passive real estate empire that throws off more income than most physical real estate.

Here's how you can get started today.

First, find some leverage

Borrowing to invest is risky, but it can also really goose returns. And since a central part of a physical real estate portfolio is borrowing, our alternate version needs debt, too.

Say an investor had $50,000 to invest. The first step would be to go to a bank and get more capital, which is usually done by borrowing on their existing house. Let's assume our investor got another $50,000 at an interest rate of prime +0.5%, which works out to 3.2%.

The next step is to invest the $100,000 in capital in an online broker that offers attractive margin rates. There's at least one in Canada that offers margin debt at the low rate of 2%.

Investors who buy large Canadian stocks only have to maintain a margin rate of 30%. This means that in theory we could use our $100,000 in initial capital to control $333,333 of securities.

That's a little extreme for me. And besides, we don't want to run into any potential margin calls. So we'll be somewhat conservative and assume our imaginary investor borrows an additional $100,000.

That's $200,000 in value controlled after contributing just $50,000 of their own money.

The interest cost breakdown goes as follows:

Bank loan: $50,000 @ 3.2% interest = $1,600
Margin loan: $100,000 @ 2% interest = $2,000
Total interest = $3,600

To pay the interest on the loan, we have to earn $3,600 annually in income.

Next, pick some REITs

The next step is to pick a number of real estate investment trusts to invest in. For the sake of simplicity, we'll look at three different REITs that, when combined, form a diversified real estate portfolio.

First up is **H&R Real Estate Investment Trust** (TSX:HR.UN), which owns office, retail, and industrial property across Canada and the United States. It is Canada's second-largest REIT by assets and pays a 5.8% dividend. It has some exposure to Alberta, a struggling market, but a 66% payout ratio ensures the company's yield is pretty secure.

Next is my favourite apartment REIT, **Northview Apartment REIT** (TSX:NVU.UN). Northview boasts a diverse portfolio of more than 24,000 units across 60 markets in Canada. Shares are currently beaten up due to disappointing second-quarter results, but the company still easily makes enough to support its 8.2% dividend.

Crombie Real Estate Investment Trust (TSX:CRR.UN) rounds out our list. Crombie is majority owned by **Empire Company**, with its stores anchoring most of Crombie's real estate holdings. Crombie also owns some office buildings and warehouses used by the company. Crombie should be able to continue growing since Empire gives it the first shot at its real estate, and it earns enough to cover its 5.8% dividend.

Finally, pocket the difference

For the sake of simplicity, we'll assume equal weights in each of these REITs–an investment of $66,666 in each.

It would buy 2,836 H&R shares, which would spin off $3,829 in annual dividends. It would buy 3,329 Northview shares and generate an annual income of $5,423. And it would buy 4,331 Crombie shares, which would pay $3,855 in annual dividends.

Altogether, an investor would have an annual income of $13,107. After paying interest costs of $3,600, that would leave $9,507 left towards paying off the original $150,000 loan. Since interest costs would go down over time, that's a payback period of fewer than 15 years.

Building a real estate empire doesn't have to involve dealing with tenants or (shudder) broken toilets. Canada's REITs can do the heavy lifting for you, leaving you free to collect your dividends. It doesn't get much sweeter than that.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CRR.UN (Crombie Real Estate Investment Trust)
2. TSX:HR.UN (H&R Real Estate Investment Trust)

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