Be a Lazy Landlord With H&R Real Estate Investment Trust

Description

There are many reasons why owning real estate is an attractive investment.

Canada has been in a real estate bull market for almost two decades now; prices just don't seem to go down. There's consistent demand for the product as more people embrace the advantages of renting. And it's easy to leverage small amounts of capital to control a lot of assets.

But there are downfalls, too. With big leverage comes at least some risk. New mortgage rules have likely made it harder to finance rental property. Dealing with tenants can be a pain, and nobody wants to deal with a plumbing emergency. Many also think Canada's real estate is primed to fall after doing so well for so long.

Luckily for investors, there's a way to invest passively in real estate, getting all the benefits of leverage without all the work of owning a place. Here's how to do it.

Create your own empire

The first thing to do is create some leverage.

Say you started out with $50,000 of your own capital with the ability to borrow $30,000 more at an interest rate of 3%. You'd then take that $80,000 and invest it with a brokerage.

The next step is picking a brokerage with low margin rates. Many brokers treat margin as a profit centre, sticking investors with rates as high as 6%. You'll want to pick a brokerage with rates in the neighborhood of 2%.

Once the money is ready to go, understand the rules for investing with margin debt. Most Canadian REITs are eligible for what's called reduced margin, meaning the equity in your account only has to be 30% of the total amount invested. Suddenly, $80,000 in original capital can control $250,000 in assets.

It's a bad idea to finance that much. If the equity falls below the magical 30% threshold, you'll immediately be hit with a margin call. If enough capital isn't added to the account to get it to good standing, the shares are automatically sold at a loss.

That’s not an ideal solution.

If an investor maintains a 50% equity and 50% debt split, then they’ll have some wiggle room in case the price of the underlying assets falls. This means an investor could end up controlling $160,000 worth of assets while only putting up $50,000 of their own cash.

Choose a REIT … wisely

Ideally, investors would use the proceeds to create a high-yield portfolio with many different kinds of assets. Diversification helps to reduce risk, which is doubly important when borrowing.

One REIT that would sure look good in such a portfolio is **H&R Real Estate Investment Trust** (TSX:HR.UN). It has a diverse portfolio with office, retail, industrial, and even a few residential assets spread across Canada and the United States. These buildings are worth approximately $13 billion, making it Canada’s second-largest REIT.

H&R not only owns quality assets; it trades at a reasonable valuation. H&R is on pace to generate $2.02 per share in funds from operations in 2016, giving shares an earnings yield of approximately 9%.

Or, to put it another way, that’s like buying a rental property, doing absolutely nothing to manage it, and pocketing 9% after all expenses, before income tax. That isn’t bad.

H&R retains some of those earnings to reinvest in new projects, but it still pays a generous dividend of 6.2%. That’s plenty of cash flow to help pay down margin debt.

Going back to our earlier example, let’s assume an investor put all $160,000 of their capital into H&R, gaining some 7,300 shares. That would generate an income of $820 per month. Meanwhile, the total cost of the debt would be $258 per month, generating a cash flow of $562 per month.

Who couldn’t use an extra $562 per month?

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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

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Author
nelsonpsmith