5 Reasons to Buy REITs Over Rental Properties

Description

Buying real estate has been a no-brainer way to make a lot of money over the last decade, especially in places like Toronto or Vancouver.

There are two aspects to a real estate investment: cash flow and price appreciation. While cash flow might be a little anemic–especially today as more people have rushed into the sector–there's no arguing with the other part. Investors have been able to count on a 5-10% increase in the value of the asset, like clockwork.

But that might be changing. B.C. recently passed a 15% buyers' tax for all Vancouver-area properties purchased by foreign buyers. The federal government tightened up mortgage regulations, making it harder to qualify. And rumours are flying that the banks will soon be asked to share mortgage default risk, rather than transferring it directly to the two major insurers.

It's obvious what the endgame is here. The government wants to deflate Canada's housing bubble. That's going to be very bad news for those who leveraged aggressively to buy at the top.

Besides, there's a better way. Here are five reasons for investors to buy REITs instead of physical property.

Passive management

Renting out a condo is a pain. First you have to drive to the place and show it to the tenant. Sometimes, the tenant doesn't even show up. Other times, they turn their nose up at the place.

Once you find a tenant that likes the place, the real work begins. You need an application form. Credit checks are usually a good idea; so are calling references and former landlords. And then you've got to coordinate with the tenant moving out.

REITs have to do all of this too, but the investor can just pretend it doesn't exist.

No repairs

Although we've all heard the stories of landlords getting called at 3:00 AM to deal with toilet issues, these rarely happen. I know a landlord with 30 years' experience who says he's never gotten a call from a tenant after 10:00 PM and probably averages one per year after normal business hours.

Still, a landlord does have to deal with fixing things. They have two options: either fix it themselves or call a professional. One is cheaper but hardly passive. The other cuts into the bottom line.

Better returns

In downtown Vancouver and Toronto, cap rates on condos are only 3-4%. Investors are banking on the capital gains.

Compare that to **Northview Apartment REIT** (TSX:NVU.UN), which owns apartments across Canada with a focus on northern markets.

Northview is on pace to deliver $2.16 per share in funds from operations in 2016, despite a dip in earnings from the Fort McMurray wildfires. Shares trade hands at $20.29 each. It's the equivalent of buying a place with an 11% return on investment.

Northview retains some of those earnings to pay down debt and make capital improvements, but it still pays investors a dividend of 8%. That's not bad for doing nothing.

Diversification

Most real estate investors are 100% exposed to one city. This is bad news when the local economy inevitably takes a dip.

REITs are much more diverse. Although they generally have one overweight region in their portfolio, it's not hard to find true, nationwide players. This substantially reduces risk without much impact on returns.

Responsible leverage

I know real estate investors who have put 5% down on a property, financing the other 95%. That's an incredible amount of leverage.

REITs can't get away with anything close to that, which is a good thing. It's incredibly risky to take on that much debt.

Compare the average real estate investor to **RioCan Real Estate Investment Trust** (TSX:REI.UN). After selling its U.S. portfolio, RioCan reduced its debt-to-assets ratio to just 38%. Most large-cap REITs try to keep debt under 50% of assets. Anything under 40% is quite attractive.

RioCan is well prepared to tough out a downturn. A highly levered condo investor isn't.

The bottom line

I used to buy physical real estate. But my thinking has gradually shifted over to REITs. I love the passive income, the diversification, and especially the attractive cash flow. Maybe other real estate investors should do the same.

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