4 Reasons Why I’m Buying REITs Over Rental Properties

Description

I love real estate. I think it’s one of the best ways for Canadians to build wealth over the long term.

You might say real estate is in my blood. My dad became a landlord in the early 1980s and hasn’t looked back since. He now lives off the cash flow delivered from more than a dozen rental properties–all long paid for.

But in 2016, I’m not so sure. Real estate values have shot up across Canada, and returns have suffered as more investors chase capital gains versus cash flow. Many pundits are worried about real estate crashing in Canada, myself included.

So I’ve chosen a different route. Here are four reasons I’m buying REITs instead of physical rental property.

Passive management

It’s every landlord’s worst nightmare: imagine getting a phone call at 4:00 a.m. about a plumbing issue.

Although that fear is overblown–my dad says he’s never gotten a phone call later than 10:00 p.m. in 30 years as a landlord–there is definitely an active aspect to managing a physical rental property.

You have to show it to prospective tenants, usually multiple times. Repairs and maintenance need to be done. And then the unit needs to be cleaned before new tenants can go in.

REITs have to deal with this too, but as a passive shareholder, you have no part in it.

Diversification

It’s hard for a regular investor to build a diversified real estate empire. Most just stick to one type of building in one location.

REITs make it easy to diversify all across Canada and, perhaps more importantly, across different types of asset classes. Most landlords stick to residential; it’s hard for the average person to scrape together a few million to own office or industrial property.

H&R Real Estate Investment Trust (TSX:HR.UN) is a perfect example. Canada's second-largest REIT owns everything from office buildings to residential apartment complexes. Approximately 70% of the portfolio is in Canada, while 30% is in the United States.

It's obvious H&R is doing something right. The company just announced an increase to its already generous 6.5% yield.

Decreased leverage

Many landlords use Canada's generous mortgage default insurance programs to employ a ton of leverage. It used to be possible for a landlord to buy property with as little as 5% down. These days, investors can still buy with as little as 20% down.

With increased leverage comes higher risk. We haven't seen a 20% decline in real estate prices for a long time, but it has certainly happened in the past. Somebody using the minimum down payment would see their entire equity go away.

REITs are much more responsible. A REIT with a debt-to-assets ratio higher than 50% is usually considered to have too much debt.

Great yields

Real estate in most major Canadian cities yields only 4-5%. That's not very exciting, especially when many REITs offer such higher payouts.

Compare that to **Artis Real Estate Investment Trust** (TSX:AX.UN), a company I own. Its portfolio is incredibly diverse, owning office, retail, and industrial property in five Canadian provinces as well as five U.S. states. Altogether, it owns 259 different properties that span nearly 27 million square feet.

Artis pays investors a succulent 9.3% yield. Some investors might look at that yield and judge it unsafe, but the company is on pace to generate $1.51 per share in funds from operations for 2016, while only paying out $1.08 per share in dividends. That gives it a payout ratio of just 71.5%, which is lower than many of its peers.

The bottom line

Owning REITs has many advantages over owning physical real estate, including passive management, better yields, and instant diversification. More real estate investors should consider REITs a better alternative versus traditional forms of ownership. I know I sure do.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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

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