Are You Ready for a Canadian REIT Crash?

Description

REITs have been a fantastic asset class for income investors over the past few years. Interest rates have been near the floor, and this provided a huge tailwind for REITs of all types. These tailwinds allowed for huge dividend yields south of 5%, but going into 2017, things will start to change as all REITs face the possibility of a potentially violent correction.

There's no question that REITs have had their time, but retirees and dividend investors who are overexposed to Canadian REITs may want to reduce their exposure right now because there are huge long-term headwinds ahead that could bring dividend yields back down to Earth.

The U.S. Federal Reserve raised rates this week and plans to do so again three more times next year. Janet Yellen had a more hawkish tone, and I do believe she means it when she says the U.S. economy has more room to run. We can expect interest rates to steadily increase over the next few years, and this is not good news for income investors who enjoyed whopping dividends from their REITs.

Depending on the quality of the Canadian REITs that are held, investors can expect capital losses and potential dividend cuts if a REIT's cash flow is unable to keep up with its payout.

President-elect Donald Trump may actually speed up the rate at which interest rates are increased. It's no mystery that he's pro-business and wants to give corporate America a boost by lowering corporate tax rates. Doing this will cause a huge tailwind for businesses across the U.S., and stocks will most likely soar into the atmosphere. This will cause the U.S. Federal Reserve to be even more hawkish, and it may make Janet Yellen raise rates even faster than originally expected.

In 2017, the party will be over for REITs, and income investors should brace themselves for lower returns and fewer dividend raises going forward.

Does this mean you should sell your Canadian REITs?

While the next few years will be hard on REITs, I don't believe you should liquidate your entire stake, but if you are overexposed, then it may be time to reduce your exposure to Canadian REITs.

If you love REITs and you're the type of investor that says, "I don't care about capital gains. I just want to collect the dividends. I'm in it for the long term, and day-to-day fluctuations don't bother me," then you may want to take a step back and analyze what this means for your retirement plan over the next few years. The headwinds facing REITs will affect dividend payouts; in some cases, if there is a crash, dividends will get cut, and you'll sell at a huge loss when this happens.

If your heart is set on REITs still, then you may want to shift to a more stable type of REIT that will not be hurt by the headwind of rapidly rising interest rates. Such REITs have high exposure to the energy sector, which will receive a nice boost thanks to Donald Trump, who is pro-energy. One such REIT is **Boardwalk Real Estate Investment Trust** (TSX:BEI.UN), which yields a bountiful 4.81% dividend yield.

You may also want to consider solid retail REITs with credit-worthy tenants, such as **Smart REIT** (TSX:SRU.UN). Its growth strategy is fantastic and may offset the headwind of rising interest rates over the next few years.

Times change, and it's important for Foolish investors to rethink their investment strategy when the tides turn. REITs will still offer great yields, but don't overexpose yourself, because all REITs may face real weakness for the long run.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BEI.UN (Boardwalk Real Estate Investment Trust)
2. TSX:SRU.UN (SmartCentres Real Estate Investment Trust)

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