Comparing 3 REIT Sectors: Which One Is Best?

Description

Investors interested in putting their money to work in the real estate market generally have two options: (1) buy the real thing, lever up with a mortgage, and invest in real property, or (2) buy a real estate investment trust (REIT) and get the desired exposure to real estate without the management headaches associated with collecting rent cheques, making mortgage payments, fixing light bulbs, and dealing with tenants.

REITs focus on having a diversified portfolio of assets, and generally spread a large pool of investment over a large number of properties, typically located in diverse geographical and demographic areas. This helps spread out as much of the systematic risk as possible while retaining the same cash flow and earnings upside traditional real estate has provided real estate investors for decades.

In this article, I'll be specifically looking at three unique REIT sectors: industrial, residential, and office to discuss some of the upside and downside to each sector for investors interested in REITS but looking for a place to start their research.

Residential

Perhaps the most common or thought-of sector for investors considering a REIT investment, residential REITs like **Killam Apartment REIT** (TSX:KMP.UN) offer investors a stable dividend around 5%, along with strong earnings growth and elevated profit margins in an area of Canada that is largely considered to be "bubble-free." In a time that is relatively uncertain with respect to housing prices in some of Canada's largest markets such as Toronto and Vancouver, Killam's property portfolio is centered in Atlantic Canada. The maritimes provinces have seen slower, but stable growth over the long-term, and Killam has done a good job of growing its portfolio of assets over the years through acquisitions and property development.

Office

Investors looking for exposure to real estate and believe in the strength of Canada's economy and corporate earnings moving forward should consider a REIT such as **Dream Office REIT** (TSX:D.UN). With expectations of global growth beginning to pick up, betting on improved economics for office vacancy rates and lease rates moving forward is a bold, but potentially very profitable bet for investors looking at REITs that have largely underperformed of late.

Dream Office REIT is down approximately 50% from its post-recession high in 2012, seeing declines from weakening fundamentals in the office space since 2012/2013. I expect the headwinds office REITs have experience will persist for some time, but these REITs are cheap and provide an interesting entry point for investors bullish on the Canadian economy.

Industrial

Industrial REITs such as **Dream Industrial REIT** (TSX:DIR.UN) have also been hit in recent years, down approximately 20% from 2013 highs on deteriorating industry fundamentals. I don't necessarily subscribe to the pessimism for this REIT sector due to improving long-term prospects with respect to fundamental changes in what "industrial" really means, and specifically changes in the ultimate leaseholders of these properties moving forward. Dream Industrial REIT owns a portfolio of highly sought after industrial real estate close to major city centers across Canada, and will benefit from continued growth in the e-commerce and distribution sectors in the long-term.

Bottom line

Killam Apartment REIT and Dream Industrial REIT are my top two picks for REITs representing sectors I believe will experience growth over the medium to long-term. Investors interested in residential or industrial REITs should consider all options available, however these two options should provide a good starting point.

Stay Foolish, my friends.

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TICKERS GLOBAL

1. TSX:D.UN (Dream Office Real Estate Investment Trust)
2. TSX:DIR.UN (Dream Industrial REIT)
3. TSX:KMP.UN (Killam Apartment REIT)

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