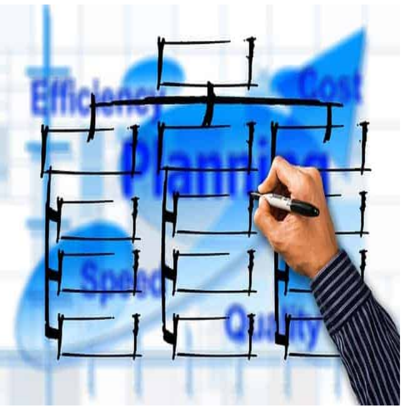

Retirees: Here’s How to Invest in REITs as Interest Rates Rise

Description

Yes, a rising interest rate environment is pretty bad news for income investors and cautious retirees who depend on their income, but that doesn’t mean you should make drastic changes to your portfolio in response to such a trend. The high-income paying securities that income investors flock to such as REITs are still rock-solid ways to preserve and accumulate wealth when you’re at the stage in your life where you can’t afford to take risks.

Unfortunately, rising interest rates are slated to have a bigger impact on Canadian REITs versus their U.S. counterparts, even though it’s likely that rates will rise at a lower rate in Canada.

Why?

Many Canadian REITs have a lower rate of tenant turnover and longer leases. That means Canadian REITs are steady, but it also means that landlords are going to have a harder time hiking rents, especially if regulators decided to implement rent control measures in the future.

Corrado Russo of Timbercreek Asset Management Inc. favours U.S. REITs, citing that REITs typically perform well in a rising interest rate environment assuming they’re not subject to unfavourable traits as many Canadian REITs are.

“In an income environment, they outperform; when people want growth, they underperform. And in a rising rate environment, people want growth,” said Russo. “If you want to protect against interest rate rises in Canada, you should be going outside of Canada to get your REIT exposure.”

Russo also noted that Canadian REITs are more akin to bonds because of their amplified sensitivity to interest rates versus non-Canadian REITs.

Should retirees dump their Canadian REITs for U.S. ones?

Although U.S. REITs are better-positioned to ride the uptrend in interest rates, Canadian investors may be worried about the implications of a 15% distribution withholding tax, which would be quite severe for high yielding securities, especially in a TFSA.

That said, I don't think it's worthwhile to swap all your Canadian REITs for U.S. ones. There are plenty of opportunities on this side of the border, especially with undervalued REITs that already have plenty of pessimism baked into the share price.

Consider **SmartCentres Real Estate Investment Trust** (TSX:SRU.UN), a shopping centre REIT that's down ~21% from all-time highs. The trust has very high-quality tenants and has been diversifying away from shopping centres with new multipurpose property projects. The company also has a fat 6.1% yield, which is considerably higher than the company's five-year historical average yield of ~5.5%.

The fears are way overblown with this Canadian REIT, so income investors seeking a relative margin of safety would do very well by taking Warren Buffett's advice to be greedy while others are fearful.

Bottom line

Many investors believe that rising interest rates are a clear negative for Canadian REIT investors, but I think it's more of a double-edged sword.

If you're a long-term investor with an ample amount of cash on the sidelines, you can spot spot huge bargains at a time when most investors are ready to throw in the towel.

Although pundits would advise you to go south of the border for your REITs, I think it's a much better idea to stay within Canada in order to avoid getting your distributions trimmed by Uncle Sam.

Stay hungry. Stay Foolish.

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TICKERS GLOBAL

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

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