Is it a Bad Idea to Hold REITs Right Now?

Description

As interest rates increase, some investors may think it is a bad idea to hold real estate investment trusts (REITs), which inherently have lots of debt. It really depends what your investment goals are. As long as you have suitable expectations for your REIT investments, it wouldn't necessarily be a bad idea to hold REITs right now.

A suitable expectation for REITs would be safe income, because that is what attracts investors to REITs.

For example, some retirees live on their investment income, and a part of that comes from REITs, which offer above-average yields.

Here are a couple of REITs that offer safe yields.

H&R Real Estate Investment Trust (TSX:HR.UN) is a diversified REIT with ~$14.6 billion of assets across +45 million square feet of office, retail, industrial, and residential properties.

Management seems keen to keep its balance sheet conservative by aiming to maintain leverage of 43-47%. The company is looking to sell its remaining industrial and retail assets in the U.S., which it estimates will generate US$800 million of gross proceeds for reinvestment.

H&R REIT generates ~20% of its rental revenue from its top two tenants, **Encana** (~11.8% of rental revenue) and **BCE** (~8.3%). They are investment-grade companies that have long average lease terms of ~20 years and approximately seven years, respectively.

H&R REIT's 2017 funds from operations payout ratio was 75%, and it had a strong interest coverage ratio of three. So, its distribution yield of ~6.6% should remain safe despite the asset sales.

The analyst at **Bank of Nova Scotia** has a 12-month target of $23 per share on the stock, which represents ~10.2% upside potential and 16.8% near-term total returns potential.

Northview Apartment REIT (TSX:NVU.UN) is a residential REIT with 25,000 suites and 1.2 million square feet of commercial space in +60 markets across eight provinces and two territories.

Northview generates ~30% of its net operating income from the northern part of Canada, ~25% from the western part, ~27% from Ontario, ~5% from Quebec, and ~13% from the Atlantic provinces. Overall, its portfolio maintains an occupancy of ~93%.

Northview's recent funds from operations payout ratio was 78%. So, its distribution yield of ~6.3% should be safe.

The analyst at Bank of Nova Scotia has a 12-month target of $27 per share on the stock, which represents ~4% upside potential and ~10.2% near-term total returns potential.

Investor takeaway

If you need above-average yields for income, you can consider REITs despite the occurrence of rising interest rates. Both H&R REIT and Northview offer safe yields of +6% today. H&R REIT seems to be the better buy for total returns. Investors who need income now should research H&R REIT to see if it's for them.

However, they should certainly wait for a dip to at least ~$23 per share in Northview for a bigger margin of safety. In any case, it wouldn't hurt to buy either stock on dips, as any interest rate hikes can create better buying opportunities in the REITs.

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