Is Now the Right Time to Be Investing in REITS?

Description

Real estate investment trusts, or “REITs,” as they’re commonly referred to, are a staple of many dividend investors’ portfolios.

REITs provide a tax-advantageous way for investors to benefit from owing real estate property, but are they the best place to be parking your hard-earned money in the current market environment?

Understanding how REITs work

REITs allow investors to take on a beneficial interest in a portfolio of retail properties.

Sometimes this can be through an interest in residential properties and apartment buildings, like in the case of **Canadian Apartment Properties REIT** (TSX:CAR.UN). In other cases, an investor can gain exposure to office properties, as with **Dream Office Real Estate Investment Trst** (TSX:D.UN). Or they can even gain exposure to a “niche” sector, such as senior’s housing, through an investment in **Sienna Senior Living Inc.** (TSX:SIA).

REITs are commonly viewed as tax-advantageous investment vehicles, as the companies operating the real estate portfolios are not required to pay taxes on the money the REITs earn, provided that money is passed through to investors.

The investors are still required to pay taxes on their personal income — either interest or dividends, depending on how the funds are received — but essentially the tax savings enjoyed by the operating company are passed along to the investor in a tax-efficient manner.

How REITs fit in today’s market environment

Usually REITs form a core staple of the portfolios many income investors and retirees, mostly because REITs in general pay above-average dividend yields.

Particularly in a low interest rate environment, like the one we have seen for the past decade, REITs become even more valuable assets, as their dividend yields compare favourably to the low interest rates on fixed-income instruments like government and corporate bonds.

Not to mention the favourable tax treatment that dividends receive compared to interest, or coupon income, within taxable investment accounts in Canada.

But now as interest rates have begun rising again, that benefit starts to fall by the wayside.

For one, Sienna Senior Living’s current 5.05% dividend yield looks pretty good against the current long-term yields on Government of Canada bond of about 2.3%, but with each passing interest rate hike by the Bank of Canada, that dividend yield starts looking less desirable, all else equal.

And then there's the fact that the vast majority of REITs employ a lot of leverage in their real estate portfolios. It's the same as when the average Canadian purchases a home, they'll typically put up a fraction of the purchase price in cash with the rest financed with debt.

But while it normally isn't much cause for concern, assuming that the property doesn't experience a significant decline in its value, but it does mean that as rates rise, the REIT's interest expense as a significant percentage of operating costs will go up and eat away at its profits, putting its dividend distributions in some degree of jeopardy.

Now might the time to look for better opportunities in other sectors, including the energy sector, which has been one of the market's hottest to start the year.

CATEGORY

1. Dividend Stocks
2. Investing

POST TAG

1. Editor's Choice

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1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
2. TSX:D.UN (Dream Office Real Estate Investment Trust)
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