Income Investors: Is This Momentum REIT a Safe Way to Inject Growth Into Your TFSA Retirement Fund?

Description

REITs have a reputation for being high yielders with little to no momentum when it comes to capital gains. With REITs required to pay 90% of taxable earnings to shareholders, it's no surprise when that your average REIT delivers nearly 0% in capital gains over the years. For many retirees and conservative income investors, however, that's completely fine, since they're getting a high yield and a high degree of safety — both attributes that retirees value most at the stage of their investment careers.

Ideally, it'd be nice to enjoy both capital gains and a safe above-average dividend yield, but is it really possible with low-growth nature of the REIT industry?

Typically, the business of collecting rent and returning a majority back to shareholders implies a low magnitude of capital appreciation and sub-par distribution growth potential. There's a lack of wiggle room for meaningful growth initiatives, and with interest rates slated to rise over the next few years, growth will be hard to come by in the REIT space. In fact, with many high-yielding REITs, what you see is what you get in terms of yield.

A 5% yield will be safe, and you'll collect it through thick and thin (unless the financial crisis repeats itself), but you're not going to get much else. Don't expect remarkable capital gains or distribution growth, although they may happen, it's important not to set the bar too high, as you'll end up disappointed should shares of the REIT you purchased remain flat or go down, all while the distribution remains static over a prolonged period of time.

What if you want a high yield and capital appreciation?

Enter high-momentum REITs like **InterRent Real Estate Investment Trust** (TSX:IIP.UN), which has surged ~80% over the past four years.

The company engages in providing a stable and growing distribution stream through the acquisition of multi-residential properties. Unlike many other REITs, InterRent has been able to deliver consistent distribution hikes over the past few years. This may seem impressive until you realize that the distribution got cut during the financial crisis over a decade ago.

With this in mind, InterRent may seem like you're surrendering a bit of safety in order to get a growing distribution and capital gains to go with the decent upfront yield. So, this momentum REIT may be more akin to a stock than a conservative high-yielding investment that's suitable for retirees.

While I believe the added momentum makes the REIT more stock-like in nature and less bond-like, I believe InterRent is a suitable holding for those seeking to spice up their conservative portfolios with a bit of growth. It's not quite as risky as your typical common stock, as multi-residential properties are an attractive sub-category to be in the REIT space.

How has InterRent been able to grow in a safe and predictable manner?

Management has been pretty smart about increasing growth without sacrificing relative safety. The trust moves into stable markets, buys undervalued pieces of real estate, fixes them up, and commands higher rents to new prospective tenants.

It's a similar strategy to "flipping" houses, but in InterRent's case, it's not selling its real estate assets; it's simply enhancing them upon acquiring them to command fatter rents and elevated FFO over the long haul for an initial capital investment. It's not a mystery why InterRent has such a fat ROE and ROIC.

InterRent's higher-growth strategy may risky like a stock, but I don't think that's the case. You're getting a unique flavour of REIT that can inject your high-income portfolio with a bit of growth. As long as management doesn't overpay for new real estate assets, I think InterRent is a "safe" distribution-growth play for retirees who wish to gradually see their income stream grow through the years.

REIT distribution growth, I believe, is underrated, especially when you consider life expectancy is the highest it's ever been.

Moreover, too many REITs keep their distributions static over prolonged periods of time, which is not good for retirees looking to combat the effects of inflation over the decades in their retirement. InterRent is a solution to this problem with its sound distribution-growth strategy.

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