Will REITs Offer You a More Relaxed Retirement?

Description

If you own rental properties, you either have to hire someone to manage them for you or you manage them yourself. If you manage them yourself, it can eat up a lot of your time, which could have been better used doing what you love.

Is it more relaxing to own real estate investment trust (REIT) stocks as a more passive way to generate rental income? Not necessarily.

In fact, retirees may be second-guessing their REIT positions in their portfolios. Real estate is not a high-growth sector in general. Higher interest rates can further dampen that growth by making it costlier for REITs to run their businesses.

REITs are going through big changes

As an example, **H&R REIT** (TSX:HR.UN), one of the largest diversified REIT on the Toronto Stock Exchange, pretty much exited the U.S. retail space, generating proceeds of about US$633 million, of which a third will be used to repay mortgage debt. This is a good thing, as it will help strengthen H&R's balance sheet, as well as reduce the interests it has to pay. It will use two-thirds of the proceeds to further invest in U.S. residential properties, which is a higher-growth area.

H&R's recent payout ratio was about 79%. The asset sales are going to push its payout ratio higher. So, it'll be prudent to wait for a quarter or two to see how the payout ratio will be affected before considering the stock for income, despite it offering a juicy 6.8% yield.

How expensive or cheap is the REIT in question?

Residential REITs, in general, have done exceptionally well — perhaps too well. Just look at **Canadian Apartment Properties** (TSX:CAR.UN) or CAPREIT, the leader in the space.

CAR.UN data by YCharts

The stock has appreciated +30% in the past 12 months, while its profitability has only been growing about 4% per year on a per-share basis.

Needless to say, CAPREIT now trades at a whopping multiple of over 23 and its yield has declined a lot.

CAR.UN Dividend Yield (TTM) data by YCharts

I just can't justify paying such a high multiple for a slow-growth stock, despite it being the best of breed in the residential REIT space.

When stocks run up so much as CAPREIT has (the stock has doubled since April 2014 and its multiple has expanded from 13.3 to 23.3), something is bound to come along to bring the stocks back to a normalized multiple. For CAPREIT, that would mean downside risk of +30%.

Investor takeaway

On one hand, it's nice to earn passive income from REITs. You can buy Canadian REITs and get rental income every month. However, retirees must be disciplined to buy quality REITs at reasonable valuations, as well as monitor them to see if they're still a good fit for your portfolio when they change significantly.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
2. TSX:HR.UN (H&R Real Estate Investment Trust)

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