Forget About Buying a House: Buy This Stud REIT Instead

Description

If you talk to Realtors, landlords, or even your parents and grandparents about investments, they all tend to share the same conclusion.

Buy real estate. You can't go wrong.

It's easy to see where these folks are coming from, especially when you look at how well real estate has done in Canada's largest cities. In the last decade alone, the average house price in the Greater Toronto Area has nearly doubled, with results even better on a 15 or 20-year time horizon. And although prices have given up ground lately in Vancouver, the average property purchased a decade ago is still up approximately 50%.

Many young people in these communities are worried they'll be priced out of the market forever, so they're buying the instant they can afford a condo. This has worked out well over the last couple decades, but it's easy to see this plan go awry today. Simply put, it's doubtful real estate can perform as well over the next decade as it did over the last. If it does, real estate will be unaffordable to the majority of the population.

Besides, there's a better investment thesis for folks who want exposure to real estate. Here's why you should continue to rent and buy some of Canada's top real estate in a passive manner.

Renting is cheaper than buying

One of the oldest tricks in a Realtor's arsenal is to point out how your mortgage payment is cheaper than rent for a comparable property. This is used as evidence to claim that buying is better, as you'll put money in your pocket while building equity.

But homes cost more than just a mortgage payment. A homeowner has all sorts of additional mandatory fees like property taxes, house insurance, and condo fees. And let's not forget about maintenance. Even condo owners will eventually have to paint the walls, replace appliances, and pay for their share of the roof repairs.

I've seen estimates that say basic home maintenance ends up costing a homeowner 1% of the value of the property each year, which translates into more than $400 per month on a $500,000 house.

Renting, meanwhile, might look more expensive on the surface, but it's the only cost you'll ever have to pay. There are no surprise repairs for a tenant. If a renter's furnace dies, it's up to the landlord to replace it.

In pricey markets, renting an equivalent place can often be hundreds of dollars cheaper each month. These savings give you the capital needed to build your own passive real estate empire.

Next, buy Canada's finest REITs

If you're impressed with Toronto or Vancouver's real estate gains, you ain't seen nothing yet.

Smartcentres REIT (TSX:SRU.UN) is one of Canada's largest retail landlords. The company has become Walmart's landlord of choice in Canada, with approximately 25% of rents coming from the approximately 100 Walmart locations it owns. Having Walmart as an anchor tenant drives traffic, which then attracts other tenants. It's a nice position to be in.

Since Smart's 2003 IPO the investment has returned 15.8% annually including reinvested dividends, which is enough to turn a $10,000 initial investment into something worth more than $100,000. That absolutely trounced the performance of the average house in even the best-performing real estate markets.

The company is nowhere near finished, either. Under Executive Chairman Mitchell Goldhar — who many consider to be Canada's finest developer — SmartCentres is embarking on an ambitious expansion plan that will see it redevelop many of its existing properties into mixed-use facilities, build other new mixed-use properties, and move into other real estate markets via joint ventures. Two interesting new segments management have identified include retirement residences and self-storage.

The bottom line

Even if I was truly bullish on Toronto or Vancouver real estate, I'd still have to say that Smart is the better investment at this point. You get access to a top-notch management team, an ambitious growth plan, and you can sit back and collect Smart's truly passive 5.1% dividend. Rather than getting involved in a potentially overheated market, just rent instead and pour your savings into great REITs like Smartcentres. You won't regret it.

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

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