Income Investors: REITs That Are Far More Rewarding Than Stocks!

Description

There are a certain class of REITs out there that have the capacity to beat your average TSX-traded stock on a returns front over a prolonged period of time. Best of all, they can do so with far less volatility than stocks thanks to their highly predictable cash flow streams.

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As you're probably aware, REITs struggle to grow at the same magnitude of non-REIT businesses due to laws that require them to distribute 90% of net income to shareholders. If you dish out $0.90 on the dollar, you've only got a dime to put towards growth initiatives, and that's after employees have been paid.

So, how the heck can a REIT be more bountiful than a stock over the long haul given these growth constraints?

The answer is, powerful secular tailwinds.

You may think most REITs would be on a level playing field because of the distribution requirements, but you'd be dead wrong. Some REITs are much better than others, and it's not solely a matter of better management (although that certainly helps!). It literally pays dividends to consider the principles taught by Phillip Fisher, investment great and author of famous book *Common Stocks and Uncommon Profits.*

In the book, Fisher describes two types of businesses: those that are "fortunate because management is able" and those that are "fortunate and able." The latter category describes businesses that not only possess management teams that are "able," but they also are "fortunate" enough to be on a favourable side of industry trends.

When it comes to REITs, I believe the "fortunate and able" philosophy applies double-time.

Here's why.

All REITs have the growth-dampening requirement to pay out most of their cash. With very little remaining to invest in growth initiatives, a REIT needs to be on the right side of a dominant secular trend to get a boost over other REITs.

Canadian Apartment Properties REIT (TSX:CAR.UN) is one REIT that I've described in the past as having returns that are stock-like in nature. The REIT posts incredible capital gains consistently and the yield, although smaller than average, is continually growing and would be much higher if it hadn't been for the massive appreciation in its shares.

CAPREIT can offer investors to best of both worlds because of it was fortunately located in two "rentee's markets," where there's a massive rental unit supply shortage that's occurred due to unfavourable local conditions.

With a tonne of properties in the Greater Vancouver and Greater Toronto Areas, CAPREIT is able to raise rents with zero backlash. It also doesn't need to feel pressured to entice prospective renters with amenities or new renovations. Renters will line up at the door, and CAPREIT doesn't need to do a thing because of the swamp of renters in its markets of operation.

Given renters in such markets are content with much less, CAPREIT may skimp on renovations and maintenance and instead use the proceeds for further investment to get new properties up and running. In a normal market where there's an equilibrium between supply and demand, such a move would increase the vacancy rate, but in Toronto or Vancouver, there would essentially be zero impact on vacancy rates.

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That's the advantage of being on the right side of an industry trend. As long as Vancouver and Toronto remain in rental states of emergency, CAPREIT will continue rewarding investors with the same magnitude of total returns. With more stringent mortgage regulations and higher interest rates, renting is the only option for many, and that's allowed CAPREIT to laugh its way to the bank.

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