How Safe Are Real Estate Investment Trusts?

Description

I was recently talking about investing in real estate investment trusts (REITs) with a family member, and they brought up something that got me thinking. These high-yield dividend stocks on the surface look excellent for any portfolio, but they are especially recommended to retirees or soon-to-be retirees looking for future passive income.

The main point is that once an REIT generates income from its properties, it must pay out 90% of that taxable income to shareholders, usually in the form of dividends, which is why the yields are so high.

It all looks like a simple solution for passive income. But is it?

My family member was worried — and warned by friends to steer clear, but she couldn't actually give a reason. So I'm now digging into whether REITs are the best option for your passive income or whether there are a few safer options.

What is it?

REITs come in all shapes in sizes, ranging from owning a number of properties from movie theatres to grocery stores, to focusing in on a certain sector. They're also great because they're liquid, like a stock.

You can buy and sell them at any time. Then there's what I already mentioned, that REITs must pay out taxable income, so if the stock performs well, those yields are likely going to go higher.

What to look for

That last point is the key: performance. When choosing an REIT, you want to dig into the company's history of earnings growth. If the company isn't growing, then neither is that passive income dividend.

That growth usually comes from REITs that are constantly looking for ways to increase occupancy, increase rents, and new business opportunities.

Take **Crombie Real Estate Investment Trust** (TSX:CRR.UN) for example. The company owns a number of grocery stores and has recently decided to buy up and build up spaces above their grocery stores. That means that without buying another property, the company has increased rents and occupancy significantly from this new opportunity.

Think ahead

Another method is to look for emerging industries due for a boost. For example, an REIT that owns malls might not be a great investment right now given the rise in e-commerce and closure of brick-and-mortar businesses.

That's why an REIT like **WPT Industrial REIT** (TSX:WIR.U) looks so inviting. The stock owns 70 light industrial properties within the United States with occupancy of 99.1%, and has been growing through acquisitions.

The company has taken advantage of the rise in e-commerce to offer companies a place for storage. Given that e-commerce is estimated to increase to be a US$1.2 trillion business by 2020, this looks like a great future investment.

Foolish takeaway

Now I'm not suggesting an investor should either put all their money into REITs, nor am I suggesting they steer clear. There are opportunities to be had in this sector, but there are also real duds to look out for.

It can be extremely tempting to see a dividend yield in the double digits and think you're set for life. But it's not always that easy.

Dig in a bit, however, and you'll absolutely find a few winning REITs that can give your retirement portfolio – or any portfolio – years or even decades of passive income. WPT and Crombie are two great places to start, with dividend yields of 5.73% and 5.83% respectively.

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1. TSX:CRR.UN (Crombie Real Estate Investment Trust)

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