Are REITs the Sells of a Generation?

Description

"I wouldn't go near real estate … they [real estate investment trusts (REITs)] are priced like tech stocks were in the 2000s," said portfolio manager Patrick Horan in a recent interview. "They are probably sells of a generation." Is he right? Should you sell all your REITs from your Tax-Free Savings Account (TFSA) before the property market crumbles?

Besides hockey and the weather, real estate could be the biggest preoccupation of most Canadians. Buying, selling, and investing in property is a national sport. So much that the value of real estate in major cities like Toronto and Vancouver has more than tripled over the past two decades.

While direct investments have been popular, indirect investments in REITs have been much more lucrative. The **S&P/TSX Capped REIT Index** is up 354% since the end of 2008, when you include dividends. Compare that to the 157% return on the **S&P/TSX Composite Index** over the same period.

Meanwhile, the dividend yield on most REITs far outstrips the dividend yield of blue-chip companies, high-interest savings accounts, and the yield on a 10-year government treasury bond.

However, there are signs that the market is getting ahead of itself and is now too big to fail. Residential construction and services are now a bigger part of the national economy than energy and manufacturing combined. Meanwhile, household debt is at a record high and property price-to-income ratios as well.

All signs point to an overvalued, if not dangerous market for investors. But not all REITs are a sell. Some are less exposed to this worrying sector.

Brookfield Property Partners (TSX:BPY.UN)(NASDAQ:BPY) for example, is less exposed to Canada's real estate bubble than most investors realize. Most of the investment company's portfolio is commercial. Much of it is also invested in the United States and Asia rather than domestically in Canada.

In fact, 96% of Brookfield's property portfolio is based outside Canada, according to its latest investor report. Well over half the portfolio, which is worth a total of US$188 billion, is in the United States — an arguably more stable and well-priced market.

The company is also supported with immense cash and resources from its parent organization, which is one of the world's largest wealth managers.

The underlying portfolio, coupled with a 7% dividend yield and the financial strength of the parent company, makes Brookfield Property a long-term buy that is insulated from the domestic property market cycle.

Similarly, REITs like **Northwest Healthcare Properties REIT** and **Inovalis REIT** are focused on markets that are insulated from the Canadian economy — such as European offices and healthcare facilities. Both offer attractive yields, 6.8% and 7.6% respectively, and are trading at reasonable valuations.

Bottom line

The concerns about Canada's property market seem justified; however, that doesn't mean investors should avoid all REITs. Some have exposure to non-residential properties abroad and may be better alternatives for passive-income-seeking investors.

Even if you're optimistic about Canadian real estate, these REITs can help you diversify your property portfolio and strengthen your monthly income.

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