Canada Revenue Agency: 1 REIT TFSA Investors Should Buy for Tax-Free Income

Description

Assuming that you play by the rules, the Canada Revenue Agency (CRA) won't tax the income generated within your Tax-Free Savings Account (TFSA). After the recent market crash, TFSA investors have an opportunity to scoop up some hard-hit real estate investment trusts (REITs) that are now trading at a fraction of their pre-pandemic prices with yields that are the highest they've been since the Financial Crisis of 2007-08.

Some of the more beaten-up real estate sub-industries now sport distribution yields that are more than double what they were before the coronavirus-induced market meltdown, providing income-oriented TFSA investors with an opportunity to "lock in" the outsized yields before they have a chance to revert to their mean levels.

Retail and office REITs look downright toxic in today's stay-at-home economy.

While there's no telling when people will start returning to offices and shopping malls again, I think there's substantial value for long-term TFSA investors who are willing to wait at least three years for the world to inch closer towards normalcy.

A colossal distribution that TFSA investors can legally shield from the CRA

Back in 2008, the REITs were effectively at ground zero of the housing market-induced market crash. The REITs, including diversified Canadian real estate kingpin **H&R REIT** (TSX:HR.UN), imploded, as TFSA investors ran for the hills. The yield of H&R REIT swelled into the double digits, and eventually the distribution got cut, as the REIT was in the midst of building The Bow in Calgary.

Although H&R REIT had a robust roster of retail and office real estate properties, the FFO payout ratio got out of hand, and there were alternative options other than taking the axe to the distribution. H&R REIT fell over 70% from peak to trough during the Financial Crisis, but those who bought shares on the decline, despite the distribution cuts, were rewarded with substantial capital gains. And as things gradually returned to normal, the distribution was initiated, and contrarians were able to outperform, as income investors returned to the name in droves.

TFSA investors: Things are different this time around

This time around, H&R REIT has suffered a similar collapse, with shares now down over 60% from their 52-week highs. The coronavirus pandemic has caused many offices and retail properties to be deserted of late. And with many tenants unable to make rent for April, with potentially more that may struggle to make rent for May, H&R REIT may be doomed to take the axe to its distribution again, as its FFO payout ratio is stretched to the limit.

With a gradual re-opening of the economy in the cards for late spring or early summer, a return to semi-normalcy may be a lot closer than most bears think. As the environment gradually improves for H&R REIT's tenants, I suspect shares of H&R REIT could be in for a massive multi-year run, as it recovers from one of the sharpest crashes since the Great Recession.

Moreover, if it turns out that the looming recession will be milder than the Great Recession, H&R REIT shares could be in for a significant correction to the upside, as shares are now severely oversold. And this time, the distribution, I believe, is more likely to survive.

Foolish takeaway

Fellow Fool Kay Ng did a stellar job in her prior piece, outlining the potential impact of the coronavirus (COVID-19) on the distributions of a REIT like H&R. Should the pandemic drag on for longer than expected (a real possibility), Kay notes that the distribution (which currently yields 15%) will still be ridiculously bountiful, even if it's cut in half.

So, whether or not the distribution stays fully intact through the coronavirus crisis, H&R REIT still looks like a wonderful deep-value income bet for extremely long-term thinkers who can think many years out.

Who knows? A best-case scenario could pan out, allowing contrarian TFSA investors a shot to have their cake (a huge distribution that's free from taxation from the CRA) and eat it too (the substantial capital gains in an upside correction). H&R REIT just landed a new $425 million credit facility and has postponed development projects to improve its liquidity position amid this potentially (and hopefully) short-lived crisis.

Stay hungry. Stay Foolish.

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