How to Make $200/Month in Passive Income Tax Free in Your TFSA

Description

Some investors buy rental properties to earn income every month. However, that's a lot of money invested in real estate, and landlords would be burdened with large mortgages to pay off. Moreover, it's not entirely passive income. Landlords need to deal with property maintenance and cater to the needs of tenants.

Why not limit your investments in real estate and diversify your capital for growth? Here's how you can sit back and make $200 a month in passive income tax free in your Tax-Free Savings Account (TFSA).

The pandemic market crash has provided opportunities to buy quality real estate investment trusts (REITs) at good valuations.

A diversified REIT

H&R REIT (TSX:HR.UN) is invested in about 470 properties across Canada and the United States. It has a diversified portfolio across office (45% share of rent), retail (33%), residential (16%), and industrial (6%) properties.

The stock is about 33% lower than in early 2020, before the pandemic market crash, because about 69% of its portfolio is in retail and office properties. The fair values of these properties have declined meaningfully last year (mostly in Q1 2020) due to the challenging retail landscape and energy sector volatility that caused concern for office properties with energy sector tenants.

However, H&R REIT's rent collection has been resilient. In 2020, the REIT reported funds from operations (FFO) per unit of $1.67, down only 5% year over year. Based on the more conservative adjusted FFO (AFFO) of $1.27 per unit, its payout ratio was 54%. Normally, its payout ratio is in the 70% range. So, there's a big buffer to protect its cash distribution. Its January 2021 rent collection was 94%, which is pretty high.

At writing, H&R REIT yields 5.17%. You can invest about $46,422 to earn $200 a month from the REIT.

Get a passive +7% dividend tax free

SmartCentres REIT (TSX:SRU.UN) is another REIT that investors can consider for passive monthly income in their TFSA. Even in the absence of government assistant programs, the retail REIT still managed to collect gross rents of 93.4% to 95.1% between October and December 2020.

SmartCentres REIT enjoys an industry-leading occupancy rate of about 97.4% across its 166 properties in Canada. **Walmart** serves as an anchor for 73% of its properties. It is also the REIT's largest tenant, contributing to more than 25% of its revenue.

About 60% of SmartCentres REIT's tenants were essential services that remained open in March to June 2020. Additionally, 98% of its revenue is from open-air centres that were opened sooner after economic lockdowns and more comfortable to shop in during the pandemic.

The REIT delivered resilient results in 2020. Its net operating income and funds from operations (FFO) marginally increased versus 2019. Its FFO per unit fell only 0.47%, resulting in an FFO payout ratio of 86.6%.

SmartCentres REIT is a rare breed that has maintained its cash distribution through the pandemic. Currently, it yields 7.17%. You can invest about $33,473 to earn $200 a month from the REIT.

The Foolish takeaway

To get $200 a month of tax-free income between the two REITs, you can invest about $39,948 in each in your TFSA. The REITs are much more diversified investments than individual properties. Furthermore, they're managed by professional teams that take care of the properties, tenants, and mortgages so that you can sit back and relax.

CATEGORY

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TICKERS GLOBAL

1. TSX:HR.UN (H&R Real Estate Investment Trust)
2. TSX:SRU.UN (SmartCentres Real Estate Investment Trust)

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