TFSA Investors: 1 TSX REIT to Boost Your Tax-Free Income Today

Description

With the Bank of Canada becoming the first major central bank to signal an early exit from stimulus-linked bond purchases, as the Canadian economy shows signs of recovery from a COVID-19-induced slowdown, investors are getting ready for potential rate hikes by late 2022. However, the Canadian central bank still maintains that it won't tinker with benchmark interest rates (currently at 0.25%) until the recovery is complete and inflation holds at 2%.

Canada's annual inflation rate rose to 2.3% in March 2021. Even if interest rates may begin to rise steadily within the next 24 months, it may take time for bond yields to sustainably rise above inflation. The average 10-year government bond yields 1.52% today. As long as inflation rates remain higher than current income yields for bond investors, purchasing power will persistently be eroded through inflation. As the situation stands, income-oriented investors may need to take on a little extra risk to boost their portfolios' real earning power.

Real estate investment trusts (REITs) belong to an asset class that was created for the sole purpose of generating tax-advantaged income for investors. They are income tax exempt, as long as they distribute the majority of their annual income to investors. The good thing is, right now, most Canadian REITs pay juicy yields while they're recovering from a pandemic slump. Yields may range from 4.4% on some of the safest distributions and rise to 9% on beaten-down trusts. If stashed in a Tax-Free Savings Account (TFSA), you can totally avoid paying taxes on REIT income.

TFSA investors: Buy residential REITs as home prices soar

The news is that the Canadian housing market is red hot right now. House prices are soaring, and rental rates could continue on the uptrend. Such an environment is favourable for residential REITs. Not only do their property portfolios increase in value, but the trusts also get to receive higher rental incomes. Both rising portfolio values and increasing rentals may mean higher profits. Trusts pay out such profits to investors.

Most noteworthy, as house prices increase, so does the average length of time first-time home buyers require to save up for that initial down payment. Even worse, as the government tries to douse the flames of an overheating housing market, obtaining that first mortgage could become harder. The result is a growing population of rent payers. Property trusts with significant investments in accommodation units have good times lying ahead of them.

Here's one such well-positioned residential REIT.

Morguard North American Residential Real Estate Investment Trust

A member of the **Morguard** family of high-performing real estate companies, **Morguard North American Residential REIT** (TSX:MRG.UN) holds a geographically diversified property portfolio of 43 multi-suite residential properties located in Canada and the United States.

Although leasing traffic declined during lockdowns, MRG's full-year 2020 earnings results contained great news for investors.

During the past year, average monthly rentals increased by 4.1% in Canada and by 1.3% in the United States. Occupancy rates remained high at 94.9% in Canada and 93.6% in the United States. Same-property net operating income grew by 3.1% in Canada and 1.8% in the U.S., while funds from operations (FFO) increased by 7.4% during the pandemic-stricken year.

Analysts expect the trust to grow its revenue by a further 1.4% in 2021. Although FFO could remain flat in 2021, MRG could return to traditional annual distribution increases by next year, as leasing traffic returns to pre-pandemic levels.

Currently, the REIT pays a safe monthly distribution that yields a nice 4.5% annually. The 2020 FFO payout rate was a safe 57%. The trust's debt ratio at 42.8% was in the industry's low range, too. Interest rate increases in 2023 won't hurt MRG that much.

Consider a potential 22% capital gain

MRG's units seem priced at a near 37% discount to their net asset value today. The trust will release its first-quarter financial results on Tuesday next week. I would be interested in management's latest estimate for the trust units' net asset value in Tuesday's earnings installment.

From the latest data within the TIKR Terminal, analysts have a target price of $19.10 on the REIT's units. This gives units a potential 22% upside within the next 12 months. This could all be a tax-free gain in a TFSA if realized.

TFSA investors could enjoy capital gains while receiving a respectable and safe income yield on Morguard North American Residential REIT units this year.

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1. TSX:MRG.UN (Morguard North American Residential Real Estate Investment Trust)

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