Are REITs Good Investments in Canada?

Description

Canada’s real estate market is hot like lava, with house prices up more than 20% year over year in February. The primary cause of rising home prices is cheap and easy money in the hands of Canadians, thanks to the near-zero interest rates and stimulus packages. Despite the sky-high prices, properties are still in demand. Why do Canadians love real estate so much?

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Investing in real estate: The risks and rewards

In the movie *Superman Returns,* a character named Lex Luthor said, “You can print money, manufacture diamonds, and people are a dime a dozen, but they’ll always need land. It’s the one thing they’re not making any more of.”

This movie was released in 2006, when house prices were at their peak. Then came the 2007 crisis, as the housing bubble burst. A similar bubble seems to be forming now, as real estate prices have surged to a level where it is becoming unaffordable for an average Canadian to buy a house. In addition, the interest rate could increase at an accelerated pace this year, making mortgages expensive.

Economists are divided about whether home prices will rise or fall, but they all agree that price growth will slow as interest rates rise. This has made first-time real estate buyers skeptical about investing in property. Investing in land can be overwhelming, as it takes up your life savings. Many building projects go into litigation for 1,001 reasons. And there are several ongoing costs, like home insurance and maintenance. If you buy an asset like real estate at a high price, you buy it for a long term (a decade or two).

Don’t just calculate returns on house price appreciation. Also, factor in other ongoing costs, like maintenance, if you are buying a house for investment purposes. With ongoing costs come ongoing income in the form of rent. Investing in real estate might look passive, but a landowner plays an active role. Then there is a risk of property damage, taxes on rental income, and capital gains tax if you sell the property.

Real estate vs. REITs

Despite the risks, real estate is an evergreen investment that will never go out of style. Even if Elon Musk makes space travel possible, billionaires would pay a huge amount to buy land on Mars. While real estate investments give good returns in the long term, the risks are high.

Real estate investment trusts (REITs) convert real estate investing into a business, where they do all the work of landlords, and you act as a passive investor. They also have a tax advantage. The Canada Revenue Agency (CRA) considers REITs as income trusts and does not subject them to corporate tax or capital gains tax. The tax is levied on the investor, who gets dividends and capital appreciation. But you can avoid this tax by investing in REITs through the Tax-Free Savings Account (TFSA).

And even if the house price bubble bursts, the largest REITs with diversified mixed-used properties will have a minimal downside.

SmartCentres REIT (TSX:SRU.UN) is the largest Canadian retail REIT and is now expanding into residential and commercial buildings. Its properties are in the Greater Toronto Area, which attracts high rent. It sustained the 2008-09 Financial crisis and the 2020 pandemic crisis without a dividend cut. That explains its resilience. The REIT has returned to its pre-pandemic level and is offering an annual dividend yield of 5.67%. If you invest $10,000 in it, it will give you at least $567 in annual dividend income in 12 monthly installments of $47.25.

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REITs are good investments only if there is demand for land and property prices are soaring. And REITs are good investments in Canada because of costly cities such as Toronto. And Canada welcomes immigrants, which increases the demand for houses. Canada also ranked first in the U.S. news report of “Best Countries in the World” in 2021 and was second in 2020, 2018, 2017, and 2016. It fell to third place in 2019. This is a good track record and shows that Canada’s property market will continue to see strong demand.

You can buy a Canadian REIT, even at current prices, to enjoy stable and regular dividend income.

CATEGORY

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