Avoid Canada's Real Estate Bubble: Bet on Foreign Property

Description

Canada's real estate sector is a mess. Homes across our biggest cities are severely overvalued. By some measures, these homes are more expensive than in world-class cities like London and Los Angeles. High levels of debt across all segments of the economy make us even more vulnerable.

Simply put, investing in domestic real estate may not be the best idea for long-term investors who are seeking a reasonable valuation. Instead, you could diversify your portfolio by betting on properties overseas. You don't need a special offshore vehicle or sophisticated tools for this. Here are the top two Toronto-listed real estate investment trusts (REITs) with foreign portfolios.

U.S. single-family homes

Higher median incomes, lower debt levels, and better valuations — there's a lot to like about American housing. Single-family homes are particularly attractive. These homes are in short supply since inventory has been declining for years. Now, millennials need to move to these homes, as they start families and look for more space.

Corporate landlords like **Tricon Residential** (TSX:TCN) have stepped in to acquire the stock and rent it to the growing renter generation. Tricon is now one of the largest residential landlords in North America with over 37,000 single-family homes across the U.S. (and some in Toronto). The stock has tripled in two years, and it still trades at just 6.7 times earnings per unit.

The fact that the majority of Tricon's portfolio is exposed to the U.S. rather than Canada makes it an ideal play for long-term investors. Keep an eye on this opportunity.

European offices

Just like U.S. residential real estate, offices in Europe are overlooked. Extensive lockdowns over the past two years have compressed valuations across the office rental sector. However, now that the pandemic is nearing an end, and offices are reopening, rents could rebound.

Inovalis REIT (TSX:INO.UN) is a top pick in this sector. The company owns and manages an extensive portfolio of offices in Germany and France. This year, the team added a number of units in Madrid, Spain, expanding the portfolio.

Rental yields are higher, and valuations lower across Europe's business centres. That makes them a better bet than residential real estate in Canada. However, this strategy is overlooked, which is why Inovalis stock has struggled to break out. It's been rangebound for years, even as rental income has steadily expanded.

Rising rents and a stagnant stock price have made this one of the best dividend stocks on the market. At the time of writing, Inovalis offers a dividend yield of 9.2%. That's far higher than the rate of inflation and the average dividend yield on domestic Canadian REITs.

Bottom line

Real estate is a robust asset class that promises reliable cash flows and steady capital appreciation. However, valuations play a key role in determining outcomes and the value of Canadian real estate is arguably overblown. That's why I prefer looking overseas for better deals. European offices and American single-family homes should be on your radar for the near term.

CATEGORY

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TICKERS GLOBAL

1. TSX:INO.UN (Inovalis Real Estate Investment Trust)
2. TSX:TCN (Tricon Residential Inc.)

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Date
2025/08/18
Date Created
2022/04/19
Author
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