5 Differences: Real Estate Investing vs. REIT Investing

Description

Here are some differences you may find useful in comparing real estate and real estate investment trust (REIT) investing. Since most retail investors don't have easy access to commercial properties, when I refer to real estate investing, I mean properties such as condos or houses.

Liquidity

Real estate investing is meant for long-term investing, as most investors need to borrow to buy a property and pay off that loan over many years, although you could choose to sell a few years later should the property appreciate meaningfully. Greater value usually comes from owning a property for decades, though. Besides, selling a property doesn't happen with the snap of a finger. So, no matter what, it wouldn't be as liquid as buying and selling REITs.

Most REITs have a high enough trading volume such that investors can sell on an open stock market immediately. If you invest in large caps like **RioCan REIT**, you won't have to worry about any liquidity issues. Small-cap REITs that have low trading volumes aren't as liquid, but investors should be able to sell at small discounts to the market price by checking the highest-bid price at the time.

Investment horizon

Investors typically don't sell properties soon after they buy. In fact, most buy property with the help of a mortgage. The idea is to use leverage as a way to build equity, pay off the debt over many years, and expect the property to appreciate in value in the long run. Therefore, real estate investing is usually a long-term investment that could easily be over a decade or two. Because REITs are much more liquid, investors can choose between short-term or longer-term investing.

Valuation

Real estate professionals have a much better idea of what a real estate property is worth. A large part of it depends on where the property is located, the reputation of the developer, and the quality of the property. No matter what, investors should get a property appraised before making an offer. The value of properties in hot cities like Vancouver and Toronto has much higher stability than in tertiary cities. Their property value will hold up much better in a housing market downturn as interest rates rise.

Analysts may use the net asset value to value REIT stocks. Price-to-funds-from-operations-ratio data can work well as a guide in valuing REITs as well.

Income generation and price appreciation

Buying a property may or may not result in any income generation. It depends if it’s a rental property or if you plan to, say, rent out a room or the basement while you live in it. However, buying the right property can lead to massive price appreciation in the long run, particularly since leverage is often used.

By carefully choosing quality REIT stocks, investors can get secure income generation from REIT investing. Look for REITs that have persistently increased their funds from operations per unit and have sustainable payout ratios.

Price appreciation in REITs can be outstanding if investors are able to invest in the dividend stocks when they trade at cheap valuations. As interest rates rise, REIT stocks have become increasingly attractive for investing. In today’s environment, investors should easily find REITs with yields of more than 3%.

Associated costs

Costs associated with owning a property include property taxes, insurance fees, maintenance and renovation fees, potentially strata fees, interest expenses on the mortgage, etc. Investing in individual REIT stocks doesn’t come with any costs other than perhaps the commission fees to buy shares, which is below $10 per trade.

In fact, some online brokerages offer commission-free trades now. So, investors can now invest in REITs with no costs at all! If you hold REITs in your TFSA, you can even save on income taxes. Since REITs are managed by professional teams, investors are getting a huge bargain at no costs if they are able to grab quality REIT units at cheap valuations.

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kayng