Real Estate Investing vs. REIT Investing: Which Is Better Today?

Description

The Bank of Canada is increasing the benchmark interest rate at a faster pace to fight high inflation, which will drive higher interest rates, including mortgage rates. Higher mortgage rates will increase the borrowing costs for real estate investing. When investing in real estate properties, landlords who are still paying back their mortgages will be faced with higher monthly payments when it comes time to renew their mortgages.

The Canadian Press wrote, "Nearly one in four homeowners say they will have to sell their home if interest rates go up further, according to a new debt survey from Manulife Bank of Canada."

Real estate investing

Most people buy real estate properties with the help of a mortgage because it's a large investment. It's essentially using debt to invest. Debt is a double-edged sword, though. All is well if landlords can make mortgage payments on time. Landlords also expect real estate property values to rise in the long run, but that's not guaranteed. But if they happen to miss a number of mortgage payments, their creditors can take ownership of their properties and sell the assets to get the lent-out money back. There's also a cost associated with ownership — property maintenance, property insurance, property tax, etc.

REIT investing

Real estate investment trust (REIT) investing may be a lower-risk way to invest in real estate at the present time. Professional management teams take care of property management, rent collection, mortgage management, etc.

REIT investors don't necessarily have to borrow to invest in REITs, although the option is available if they believe they can earn a higher return than the interest they're borrowing at, such as from a personal line of credit.

There are several other reasons that make REIT investing lower risk. Investors can dollar-cost average into these real estate investments. That is, unlike investing in a real estate property for which investors have to pay a lump sum, REIT investors can build positions in REITs over time. In market corrections, REIT investors will be able to buy REITs at substantial discounts, which can drive exceptional long-term returns. Of course, they also earn a nice cash distribution yield in the meantime.

REITs are also diversified. Typically, REIT portfolios consist of several dozens to hundreds of real estate properties. Furthermore, REIT investors can buy REITs in different industries. For example, residential REITs, industrial REITs, healthcare REITs, and data centre REITs are all good considerations.

And once your REIT cash distribution is big enough to buy a full share, investors can choose to turn on the dividend-reinvestment plan (DRIP) to reinvest for more shares. DRIPs make perfect sense during market downturns.

Buy REITs for good income

REITs are becoming increasingly attractive for income in a rising interest rate environment as their stock prices have retreated. Interested investors can look into quality names like **NorthWest Healthcare Properties REIT** and **SmartCentres REIT** and consider averaging into positions if they fit their diversified investment portfolios.

Both REITs yield more than 6.4% at writing. NorthWest Healthcare Properties REIT generates stable cash flows from hospitals, medical offices, and medical facilities. It has long-term leases to support its cash flow and juicy cash distributions. SmartCentres's largest tenant is **Walmart**, which contributes about 25% of its revenues.

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