2 Canadian REITs That Can Pay You Rent of Over 5%

Description

Do you know why piggy banks are so wise? Because they're filled with common cents. These dad jokes are growing on me, and this one in particular eludes to an investment strategy: filling your Tax-Free Savings Account (TFSA) piggy bank with simple income-generating REITs. Real estate is one investment I will make without a doubt.

Canadian REITs that pay rent of over 5%

Growing interest rates have pulled down property prices. But these prices are still nowhere close to affordable. Owning a house is still a dream that often involves paying a mortgage for 20 years. Commercial property or retail stores are even more expensive. And if you already own a primary residential property, a second property for investment purposes won't be tax-efficient. There's a capital gain tax, property tax, tax on rental income, and maintenance costs.

A wise way to earn rental income is through REITs. Residential REITs offer a low-distribution yield as the government has a cap on residential rent. Here are two REITs with a diversified property portfolio and tenants that pay millions in rent.

- **Choice Properties REIT** (TSX:CHP.UN)
- **Dream Industrial REIT** (TSX:DIR.UN)

Choice Properties REIT

As Canada's largest REIT, Choice owns 701 properties, predominantly retail (79%), and the rest are industrial and residential. Choice exited the office market by selling six office properties to **Allied Properties REIT** in the second quarter. However, Choice had to make an unfavourable adjustment of $158.7 million as rising interest rates pulled down the fair market value of its investment properties. It reported a net loss of $11.8 million in the second quarter because of a net fair value loss on investment properties.

However, this did not impact its rental income, a significant portion of which comes from retailer **Loblaw** . Choice Properties REIT had an occupancy rate of 97.6%. After the second quarter ended, Choice renewed 42 of 44 retail leases with Loblaw for an average rent increase of 5%. These Loblaw leases were due to expire in 2023, but they're now extended by 7.7 years. This hints that Choice is unlikely to cut the distribution in a recession.

The decline in real estate prices also pulled down the stock price of REITs. Choice's stock fell more than 13% in the 2022 market downturn that began in April, increasing its distribution yield to 5.39%. Now is a good time to lock in this high yield for a long time. The fair market value is declining due to economic weakness. But when the economy recovers, property prices could increase and revive Choice Properties REIT's stock price.

Dream Industrial REIT

Dream Industrial REIT has a portfolio of 244 industrial assets, primarily distribution and urban logistics properties. These properties are spread across Canada, Europe, and the United States. Dream Industrial has a strong balance sheet and a diverse tenant base, with its top 10 tenants accounting for just 12.2% of its rental income. Reduced dependence on any single tenant brings stability to the rental income. Hence, the REIT has been paying regular, stable monthly distributions without any cuts since 2013.

This REIT is yet to release its second-quarter earnings, which would reflect any losses in the fair market value of investment properties. Its stock price has dropped 22% since its April high. As with the case of Choice, even Dream's property value correction is temporary. When the recession subsides and growth returns, the property value will appreciate. This is the time to buy Dream Industrial REIT stock, and lock in a 5.67% yield and a 20-30% capital appreciation during recovery.

The REIT's stock price reflects the value of its properties. In the past eight years, its stock price fell after every crisis as industrial properties are sensitive to macroeconomic events. But in all past instances, the stock price jumped to the pre-crisis level during recovery. Given that the stock is trading at around $12.3 at the time of this writing, it could surge 30% and return to the pre-recession level of over $16.

Final takeaway

Like real estate, return on REITs attracts capital gains and income tax. But you can make the income tax-free by investing through your TFSA. In other words, the amount you invest will be taxed but the rental income and capital gains realized won't be.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CHP.UN (Choice Properties Real Estate Investment Trust)

2. TSX:DIR.UN (Dream Industrial REIT)

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pujatayal