Why REITs Are a No-Brainer Addition to Your Portfolio

Description

A simple way to think about investments is to focus on the current and future income that they can provide. In that sense, real estate investment trusts (REITs) are a no-brainer addition to investors' portfolios. Professional teams manage the diversified real estate portfolios in REITs. Canadian REITs typically pay out monthly cash distributions, which are excellent passive income for investors.

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On the **TSX**, investors can find residential, office, healthcare, and retail REITs. Here are some examples.

Killam Apartment REIT

Killam Apartment REIT (TSX:KMP.UN) yields 3.9%. The residential REIT has a track record of paying solid income. Specifically, it has maintained or increased its cash distribution since 2007. Its five-year dividend-growth rate is 2.8%. Its sustainable adjusted payout ratio is about 75%.

The REIT's portfolio is primarily in eastern Canada. It generates about 34% of its net operating income from Nova Scotia, 20% from New Brunswick, and 23% from Ontario.

The stock is down 25% from its 52-week and all-time high. The valuation of the stock has come down due to higher interest rates. Now, analysts believe it's undervalued by about 17%, which means 21% near-term upside is possible.

Allied Properties REIT

Allied Properties REIT (TSX:AP.UN) offers a juicy yield of 5.3%. The office REIT is a Canadian Dividend Aristocrat with a 10-year dividend-growth rate of 2.6%. Similar to Killam, the office REIT stock has also sold off in the face of rising interest rates. Specifically, the stock is about 32% lower from its 52-week high. Another concern is a shift of working away from the office post-pandemic. It's a big question mark whether the shift will be material and permanent.

The office REIT invests in a portfolio of top-quality office properties with a recent occupancy rate of 89.5%. In the first half of the year, it saw diluted funds from operations (FFO) per unit growth of 2.4%. As well, its FFO payout ratio of 72% is sustainable.

In an improved operating environment, analysts believe the stock can trade 27% higher. It pays investors well to wait for price appreciation.

NorthWest Healthcare Properties REIT

NorthWest Healthcare Properties REIT (TSX:NWH.UN) has been more resilient than the other two stocks as a global healthcare REIT. The units are only 9% below its 52-week high. Although the REIT doesn't have a tendency of increasing its cash distribution, it pays the highest yield of 6.1%.

The REIT generates rental income from long-term contracts diversified across more than 2,100 tenants in eight countries. Its assets include essential healthcare infrastructure like hospitals and medical office buildings. Its occupancy rate is high at about 97%. Furthermore, its cash flows are high quality, including having a weighted average lease expiry of 14 years and 82% indexed to inflation.

Analysts believe the stock is fairly valued and can appreciate about 13% over the next 12 months.

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Income tax on REITs' cash distributions

REITs pay out cash distributions that are like dividends but are taxed differently. In non-registered accounts, the return of capital portion of the distribution reduces the cost basis. The return of capital is tax deferred until unitholders sell or their adjusted cost basis turns negative.

REIT distributions can also contain other income, capital gains, and foreign non-business income. Other income and foreign non-business income are taxed at your marginal tax rate, while half of your capital gains are taxed at your marginal tax rate.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AP.UN (Allied Properties Real Estate Investment Trust)
2. TSX:KMP.UN (Killam Apartment REIT)
3. TSX:NWH.UN (NorthWest Healthcare Properties Real Estate Investment Trust)

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