



The Best Real Estate Dividend Stock for a Decade of Passive Income

Description

If you are looking for passive income, you have to invest in a passive industry that remains stable for decades. Think of it this way: what haven't you changed in the last 10 years? Have you changed your job, internet connection, laptop, house, or office space? You've got your answer.

Why invest in real estate?

The real estate industry has evolved in the last two decades. Many real estate developers and retail giants with a chain of shops adopted the real estate investment trust (REIT) model. A REIT owns and develops properties and leases or sells the space. It distributes a significant amount of its income from rent, mortgage interest, and capital gains from the sale of properties to shareholders. REITs have a higher distribution yield than corporations, as they receive special tax considerations. Hence, real estate is one of the best industries for passive income.

Note that REITs call their passive-income distributions and not dividends, as they have different tax treatments. You fill out a T5 form for dividends and pay a preferred dividend tax rate. You fill out a T3 form for distributions and pay your marginal tax rate on rental and interest income and capital gain tax on capital gains.

You can avoid all these tax calculations simply by investing in REITs through your Tax-Free Savings Account ([TFSA](#)) or Registered Retirement Savings Plan ([RRSP](#)). TFSA withdrawals are tax free, but RRSP withdrawals are not. However, all REIT distributions are considered income when withdrawn from RRSP.

How to build a passive-income portfolio with real estate stocks

But there is more to real estate than just REITs. There are real estate mortgage companies that pay significant dividends while giving you exposure to a different asset class. I have identified two real estate stocks to build your passive-income portfolio.

Passive income from rent

The stock prices of REITs fell, as the Bank of Canada [increased](#) the interest rate by 50 basis points in December. REITs are sensitive to interest rate hikes, as they take debt to buy and develop properties and earn a weighted average cap rate on leased properties. An interest rate hike shortens the gap if the REIT has a higher loan.

True North Commercial REIT ([TSX:TNT.UN](#)) stock price fell over 3% this month, which inflated its distribution yield to 10.1%. The REIT has a high leverage ratio of 58.4%, with a weighted average interest rate of 3.46% as of September 30. Since then, the central bank has hiked interest rates by 1%. The REIT also increased its lease spread by 1.3% to cover the interest cost.

So far, True North Commercial REIT has enough cash flow to manage interest expenses and sustain the current distribution of \$0.594 a year. In January 2023, the REIT will complete 10 years of paying regular monthly distributions. Investors are worried about a distribution cut next year, but the REIT shows no signs. Even if it slashes distributions by a third to \$0.39, it represents a 6.6% yield on the current stock price of \$5.88.

It is safe to say that the REIT can continue giving passive income for another decade, unless there is a major macro event.

Passive income from mortgage interest

The best way to diversify your portfolio is by buying stocks that react differently to the same situation. While the interest rate hike negatively impacts True North Commercial, it positively affects **Timbercreek Financial** ([TSX:TF](#)).

Timbercreek Financial offers short-term mortgages to commercial properties, with 87% of its loan portfolio on floating rates. As of September 30, interest rate hikes increased Timbercreek's interest income by \$8 billion in the third quarter while reducing its loan origination processing fees by \$1 billion. Overall, its net income increased by 30%, reducing its payout ratio on distributable income to 86.2% (103.7% in the third quarter of 2021).

Timbercreek Financial's stock slipped over 7% in December, inflating its distribution yield to 9.2%. The stock is relatively new and has been paying dividends since 2017. But it has the potential to pay passive income for a decade.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:TF (Timbercreek Financial Corporation)
2. TSX:TNT.UN (True North Commercial Real Estate Investment Trust)

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