Financial Post

Personal Finance

Returns without the bricks and mortar

In this story: | **CM** $83.75 $0.00

Data delayed at least 15 min

Real estate investment trusts give you the tax benefits of owning without the hassles of physical ownership.

Chris Bolin / National Post files

Jonathan Chevreau, Financial Post · Apr. 9, 2011 | **Last Updated: Apr. 11, 2011 7:58 AM ET**

Want to invest in real estate without the hassle of becoming a landlord?

Pretty much every advantage of buying property directly and renting it out can be achieved passively through REITS or funds invested in them.

In a popular blog this week at financialpost.com, fee-only financial planner Jason Heath wrote that real estate is a "secret" tax shelter because few advisors make money recommending its purchase. He focused on direct ownership of rental real estate and the tax deductibility of related expenses like interest.

While perhaps not all advisors openly discuss this "secret," there's certainly no shortage of real estate gurus happy to do so.

Vancouver-based Don Campbell, author of the best-selling Real Estate Investing in Canada, has helped thousands of Canadian investors climb the hefty learning curve to real estate riches.

Among the advantages of owning bricks and mortar (or underlying land) are control over revenues and management of properties, and the potential to add value through improvements or well chosen locations, he says. Borrowing can add to both potential reward and risk, but with dedication and planning, there's no reason you can't try to emulate Donald Trump.

CIBC Wealth Management's managing director of tax, Jamie Golombek, says there's a common perception that real estate investors can sit back and collect the rent, "but pipes break and roofs leak and someone has to fix them. If you're not big enough to keep a superintendent on call, that person is you."

Fortunately, those who want the benefits but not the hassles have an alternative. If you're comfortable with stocks, bonds or investment funds, real estate can be considered just another asset class. A study by Chicago-based Ibbotson Associates found Real Estate Investment Trusts (REITs) boost return, even when adjusted for risk, if a 10 to 20% weighting is added to traditional portfolio of stocks and bonds.

Anything you do as a landlord — including use of leverage and favourable tax treatment of rental incomes — can also be realized through individual REITS or exchange-traded funds holding baskets of them.

The price of such convenience is annual management fees. But in return, you get diversification, less risk and more liquidity. Owners of a local duplex apartment concentrate risk in one location and it takes months to sell — with commissions of 5% or 6%. Owners of publicly traded REITs or real estate mutual funds can cash out any business day.

Michael Nairne, president of Tacita Capital Inc., puts 8% to 10% of client investable assets in real estate or REITs, Canadian and foreign. While a principal residence is the best tax shelter of all because of the tax-free capital gains family units enjoy, he views homes as consumption items and not part of the 10% investment allocation.

REITs topped all asset classes in the decade ended February 2011, with a 13.7% compounded return, but Mr. Nairne expects a more modest 6% to 8% from here. One easy way to play them is via the iShares S&P/TSX Capped REIT Index Fund [XRE/TSX] or the BMO Equal Weight REITs Index ETF [ZRE/TSX]. Both have MERs of 0.55%.

Many REITs or ETFs are publicly traded, but investors can instead choose private real estate deals, which are less likely to move in tandem with stocks, says David Kaufman, president of Westcourt Capital Corp. REIT payouts are tax effective when the money is distributed as Return of Capital, deferring some tax for years. Their consistent distributions are well in excess of dividend-paying equities. “I can’t think of a compelling reason why you’d own real estate if you could find a well-run REIT or why anyone would provide a private mortgage to the guy down the street when you can buy a well-run MIC,” Mr. Kaufman says.

MICs are mortgage investment corporations, which can be private or public ones like Timber Creek (TMC/TSX) or Firm Capital (FC/TSX). Payout may be 8% a year, but MICs are less tax-effective than REITs because they spin out 100% income, taxed like interest or earned income.

Individual commercial REITs provide more potential reward but more risk: most suffer from anchor-tenant risk. Apartment REITs are less risky since people must live somewhere. ETFs own both, plus riskier REITs focused on hotels or nursing homes.

Investors contemplating buying a local triplex might instead consider something like the privately run Centurion Apartment REIT, which invests in Ontario rental units. Centurion president and CEO Greg Romundt sees little difference between the landlord route and the indirect route in terms of tax impacts, except the former have more control and more work.

“I don’t believe there’s anything about real estate which is remotely passive,” he says.

Those excited by books and seminars have a distorted view of investment real estate, Mr. Romundt says. Because of the ease of listing properties on the web, real estate is as efficient a market as stocks and bonds. That makes it harder to make a killing exploiting bargains. Newcomers are up against full-time professionals who “pick the bones of newbies.”

David Chilton, author of the forthcoming The Wealthy Barber Returns, says being a landlord is twice as much work as people think. However, lack of liquidity works in their favour because unlike stock investors, landlords are less likely to panic because they can’t get in and out quickly.

jchevreau@nationalpost.com

Get the National Post newspaper delivered to your home

© 2011 National Post, a division of Postmedia Network Inc. All rights reserved. Unauthorized distribution, transmission or republication strictly prohibited.