Remember to do the REIT thing

Olivia Teek, MBA
July 2017

REITs were established as an asset class in the US in the 1960's. Since then, REIT legislation has been recognized in 37 countries. The largest and most mature of the non-US REIT markets in terms of market cap are Singapore, continental Europe, the UK, Hong Kong, Japan and Australia.

For a company to achieve REIT status it must (amongst other criteria):

- invest at least 75% of its total assets in real estate
- derive at least 75% of its income through rentals, generated by the property assets it owns
- pay out at least 90% of its taxable income as dividends to shareholders

In this article, we will discuss the six most apparent reasons why doing the REIT thing (by including it in your portfolio) is doing the RIGHT thing.

D^{3}LHT (Dee Three Elle H Tee, for easy recollection)

1. Double Digit Total Returns

REITS have returned 11% over the 22 years up to 2016, while equities have returned 9%.

Total return includes two groups of return:

- **Income** including dividends and distributions
- **Capital appreciation** representing the change in the market price of a share

The most commonly known of the characteristics of a REIT already mentioned is the required pay-out of at least 90% of its taxable income as dividends. Companies, on the other hand, can hold onto their earnings. This difference most often leads to the very stable and predictable income streams within REITs.

Moreover, the REIT market has outperformed the equity market over the past 22 years due to a bullish long-term bond market as well as very strong fundamentals which have underpinned strong cash-flow growth. Regardless of the bond market environment in the future, Reitway's view is that investing in REITs with the right fundamentals will continue to result in sustainable wealth creation for investors.

2. Dividend Reliability

The contractual and duration nature of rental income result in REITs delivering dividend streams that come with a high degree of certainty.

The US is an accurate proxy for the rest of the world as REIT legislation was initiated there and has the largest REIT investable universe. The average dividend yield from REITs in the FTSE NAREIT (National Association of Real Estate Investment Trusts, based in Washington DC) All REITs Index was approximately 4.16% versus 2.0% for the S&P 500, as at July 2017.

3. Diversification

REITs in some sense act as a hybrid asset class as they combine equity-like appreciation with bond-like yields (income certainty).

The correlation is low between REITs and equities as well as REITs and bonds. This makes REITs a very important component of a well-diversified investment portfolio as they enhance the risk/return profile. Real Estate has its own drivers and cycles that are very different to equities and bonds and therefore promote diversification.

Our research, spanning a wide range of sources, indicates that the optimal allocation to REITs in a well-diversified portfolio is 17-20%. However, many investors that we at Reitway have liaised with are under the impression that a 5-10% allocation is optimal.

4. Liquidity and cost

Investing in physical property comes with high initial costs. These include agent fees, transfer fees, bond fees, ongoing maintenance and monthly levies and taxes. Similarly, when the decision is made to sell it can take months or even years for a sale to be finalised.

REITs offer investors real estate exposure without the usual liquidity risk associated with direct property investing. Investing in individual REITs or REIT funds gives investors access to a portfolio of properties at lower transactional costs, as well as the ability to move in and out of them quickly through open and liquid public markets.

5. Hedge against Inflation

Real estate income is earned from rentals. Since inflation protection is embedded in the rental contract through inflation-linked adjustments and fixed percentage increases in rents, REITs bring a natural hedge against inflation.

Dividend growth adds to this inflation protection. Financial and operational leverage as well as income reinvestment in property has meant that dividend growth has outpaced inflation growth over time.

6. Transparent corporate structures

It would be extremely difficult for REIT management to hide accounting irregularities for an extended period, as this would eventually effect their ability to pay out their required dividends.

Coupled with this is the fact that REITs are under inspection from analysts and underwriters that would soon pick up on any misnomers. REITs are publicly traded firms and therefore face a high degree of scrutiny. In the United States alone there are 30 firms that provide real estate equity research.

REITs are not immune to scandals, but the structure of REITs reduce the probabilities of fraud significantly.

Conclusion

Including REITs in your investment portfolio can be highly beneficial and this strategic allocation plays an important part in any diversified investment portfolio.

However, these unique, portfolio enhancing qualities of REITs do not come without risks. Given the relatively focused nature of the REIT market compared to the broader equity market, active management tends to be important in the REIT space. Correspondingly, not all REITs are created equal. There is a healthy level of dispersion within this market allowing active managers, such as Reitway, the opportunity to generate alpha.

Are you doing the REIT thing?

For more information about Reitway Global Property Funds, please visit our website at www.reitwayglobal.com or contact us on 021 551 3688.