

REAL ESTATE INVESTMENT TRUST: The Value Edge of REITs in your Portfolio

Real Estate Investment Trusts (REITs) are designed to provide extended, wholesale and retail investment window to tap into the value potentials of the real estate sector. Reits hold income-producing assets and trades units like a stock on an exchange. The assets held in Reits are such that generate steady flow of income, such as lease and rental payments from office, other commercial and residential buildings. The income earned is passed on to the unit holders in the trust. Reits by their nature offer specific advantages that make them highly desirable in portfolio construction, particularly for the institutional investors such as the pension fund administrators (PFAs), insurance firms, and asset management companies.

STEADY AND REGULAR INCOME

The consistency of income is very critical to investors – be it institutional or individual. This regularity in income is what gives a REIT some level of advantage over other instruments. REITs income is derived from three main sources – rental or lease income, income from property acquisitions and trading activities, and funds from operations. The rental and lease income is locked in and already guarantees a significant portion of the earnings for the year. These earnings are further enhanced by additional income from property acquisition and trading activities as well as funds from operations. REITs typically seek growth through acquisitions, and further aim to realize economies of scale by taking in efficiently run properties. Economies of scale would be realized by a reduction in operating expenses as a percentage of revenue.

STEADY GROWTH IN YIELD

A REIT must pay out high dividends in order to enjoy the tax benefits of REIT status. The tax benefit derives from a fundamental requirement that makes it mandatory for 90% of income to be distributed as dividends. Therefore a stable income combines with price appreciation to offer yields that maintain steady growth. REITs have strong prospects for growth in revenue, such as rental income, related service income and funds from operations. A well-managed REIT adopts a unique strategy for improving occupancy and raising its rents.

HEDGING AGAINST INTEREST RATE AND PRICE VOLATILITY

In the global market, REITs became one of the ready and available options as interest rates collapsed in the past few years to multi-decade lows. Investors

MARKET UPDATE

	15/01/13	15/12/13	04/07/14
Naira/US\$	157.65	159.94	163.07
Brent, US\$/BBL	109.78	107.84	113.19
COCOA, US\$	1487.82	2685.47	2760.56
MPR%	12.00	12.00	12.00
INFLATION RATE %	10.3	7.9	8.0
MORTGAGE RATE %	22.0	23.0	23.0

STOCKS CONSTITUTING GMA INDEX

STOCKS	31/12/13 Price (N)	04/07/14 Price (N)	%Change in Price
OANDO	24.25	28.50	47.53
GTBANK	27.02	29.60	9.55
OKOMU	44.00	33.00	-25.00
STANBIC	21.35	26.73	25.20
DANGSUGAR	11.70	9.30	-20.51
FIDSON	2.79	3.25	16.49
TRANSCORP	4.35	5.24	20.46
CCNN	11.75	11.50	-2.13

	PRICE(N)	NAV (N)
	31/01/14	04/07/14
UHOREIT	50.00	51.00
UPDCREIT	10.00	10.18

Index	31/12/13	04/07/14	% Change
NSE ASI	41,329.19	43,031.83	4.12
GMA Index	1.50	1.65	9.99

Source: CBN, SEC and NSE

had no choice but to flee to real estate investment trusts, dividend-paying stocks, and foreign government bonds. Low interest bearing instruments totally fell out of choice. Also the overbearing price volatility which generally tended downwards greatly depleted portfolio values. But these upheavals were easier to manage for those that balanced their portfolio on reits which offered steady income streams.

DIVERSIFICATION ADVANTAGE

Pooling and distributing financial assets provides greater ability to diversify risk and provides investors with more choice as to how much risk to hold in their portfolios. Most institutional investors in Nigeria are heavy on equities and government

bonds. This provides a very narrow shield to their portfolios. The gradual penetration of REITs instruments in the market has the potential to provide investors with the window to diversify their portfolio and reduce their risk exposure as a result of over concentration of their investment in one sector or instrument as is currently the case in the market.

RESILIENCE EDGE

In the US REITs bounced back much more easily from the financial crisis and recession than any other investment option. In the first 12 months after the meltdown, REITs outperformed the general market. The industry also reestablished its access to the capital markets for both equity and debt. A recent report from the National Association of REITs (NAREIT) reported that a U.S.-based REITs raised \$22 billion in capital during the first six months of 2010. The report said that \$10.9 billion of debt was raised, with the balance in equity split between initial and secondary offering. NAREIT also reported that the FTSE/NAREIT index had a 10.23% compound annual total return for the 12 month period ending June 30 of same year. The index is composed of 148 U.S.-based REITs. This compares favourable over the Standard & Poor's 500 Index which had a compound annual total return of -1.59% over the same time frame. Several REITs have gone public in 2010, in a variety of sub sectors including retail, office, lodging and industrial.

CORE ADVANTAGES IN REITS INVESTMENT

REITs are true total return investments. They provide high dividend yields along with moderate long-term capital appreciation. Unlike traditional real estate, many REITs are traded on stock exchanges. An investor gets the diversification real estate provides without being locked in on the long term with challenges of liquidity. REITs run on very strong management. The rather technical nature of REITs makes it imperative for strong and quality management with experience. Also REITs have clearly developed strategies for searching and loading great properties and tenants.

CONCLUSION

Real estate has long been a popular asset class as it tends to offer excellent long-term returns with relatively low correlation to equities and can also serve as a viable hedge against inflation. One of the best things about the expansion of the ETF universe is the extent to which it has spawned numerous vehicles for investors to easily and cost-effectively gain exposure to otherwise out-of-reach areas of the market like real estate. Real estate is a fast growing subsector of the Nigerian economy. It therefore warrants a closer look from anyone looking to add real estate exposure to their portfolio to look in the direction of REITs. Most investment advisers believe that real estate should be a core holding in almost all portfolios, due largely to its low correlation with equities and resistance to inflation.

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