A SIMPLE GUIDE TO REAL ESTATE INVESTMENT TRUSTS (REITS)

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Real estate investment trusts (REITs) were first launched in the US in 1960 and have developed into a global asset class with a market capitalisation of US$1.5 trillion* across 39 countries and growing. Typically, REITs are mandated to pay out approximately 90% of income to shareholders, in the form of dividends, so they tend to be popular with income-seeking investors.

*Source: Bloomberg as at 30 June 2019.

What is a REIT?

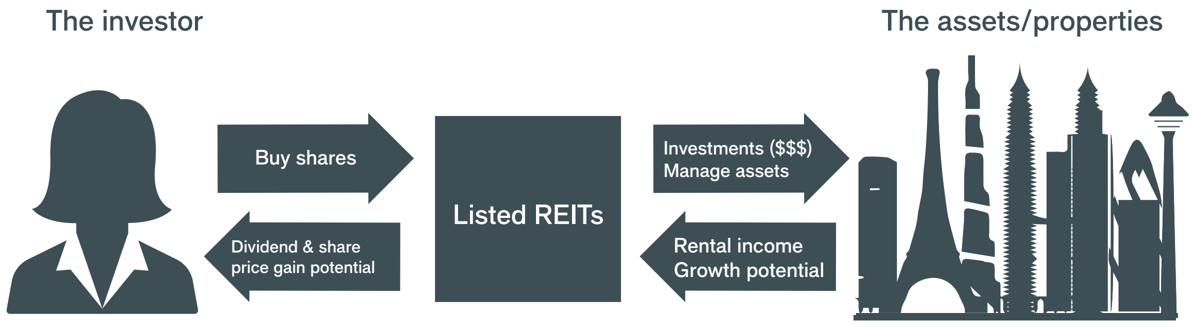
A REIT, or Real Estate Investment Trust, is a company or group of companies that own and manage real estate. Many REITs are traded like a stock on the main stock exchanges (listed REITs), while others are also available to the public but not listed on a stock exchange or privately owned.

REITs are a simple way for investors to add an allocation to property in their portfolios. REITs operate by owning buildings, leasing space to tenants and paying the majority of this income to shareholders.

REITs are considered to be tax efficient because in exchange for distributing approximately 90% or more of taxable income to shareholders, REITs gain tax-exempt status at the corporate level. Instead of being taxed at the corporate level and then the investor level, profits are passed through to investors, who typically pay tax on dividends as ordinary income or property rental income, and any capital gains tax that might be applicable when they come to sell shares in the REIT.

REITs held in a tax-exempt wrapper may allow investors to shelter their investments from tax. Please note that tax rules differ across countries so investors should check how REITs are taxed in their jurisdiction.

How does a listed REIT work?



What do REITs invest in?

REITs and funds investing in REITs typically seek to invest in high quality property assets. Over time, REITs have expanded beyond investing in traditional real estate, such as retail, office, industrial and residential. Increasingly, REITs are investing in alternative real estate sectors perceived as 'high growth', such as logistics, cell towers, data centres, student accommodation and self-storage.

How are listed REIT shares valued?

Like other publicly listed companies, listed REITs are priced by the market throughout the trading day. Among the key criteria used to evaluate the value of REIT shares are:

- Underlying value of the real estate assets (net asset value or NAV)
- Expected growth in company earnings
- Expected return from the listed REIT (REIT share price gain/loss plus dividend paid)
- Current dividend yield relative to other yielding investments, such as high yield bonds and dividend-paying stocks
- Management quality

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Why invest in REITs?

Diversification Global REITs have historically shown they generally have a low correlation to the performance of bonds and equities, making them an efficient way to diversify investor portfolios and potentially enhance risk-adjusted returns[1]. [1]Source: European Public Real Estate Association (EPRA), as at 31 March 2019. Note: 36-month data to 31 December 2018. Past performance is not an indicator of future performance.	**Income** Due to distribution requirements to pay out 90% of income, REITs can offer an attractive and reliable income proposition characterised by steady earnings and dividend growth. Over the long term, reinvested dividends have accounted for around two thirds of listed global REIT returns[3]. [3]Source: Bloomberg. FTSE EPRA/NAREIT Developed Total Return Index, 1 January 1999 to 31 March 2019.
Defensive nature REITs can provide regular income through dividends. This, coupled with typically steady cash flow generative business models backed by tangible assets, potentially make REITs an effective, defensive asset class. Over the long term, REITs have been less volatile than the general market (global equities) meaning they have been less subject to general market movements[2]. [2]Source: Janus Henderson Investors, Factset. FTSE EPRA NAREIT Developed Total Return Index (global REITs) versus MSCI World Index (equities) from June 2010 to June 2019. Past performance is not an indicator of future performance.	**Liquidity** Listed REITs are an easy and efficient way to invest in real estate; the shares are traded daily on major stock exchanges like other equities.
Transparency Listed REITs can offer investors access to high quality real estate assets with professional management platforms, combined with the transparency and oversight of investments listed and traded on public markets.	**Potential for inflation protection** Dividends from REITs have the potential to grow more than the rate of inflation. For example US REIT dividends have outpaced inflation in all but two of the last 20 years (Source: EPRA, 1998 to 2018). Rents and values typically increase as prices do.

What are the risks?

Listed REITs are subject to market fluctuations (like an equity) as well as weakness in the underlying real estate assets they hold.	While listed REITs pay regular dividends, they should not be considered as an alternative to bonds since like all equities, they carry greater risk than most bonds.
Property prices can change quickly and REITs that are funded by a high level of debt (leverage) can fall into financial difficulty if rental income declines, affecting the ability to service debt repayments.	During periods of high inflation or accelerating growth expectations, investors typically focus more on growth than income. In this type of environment REITs performance is more likely to lag the wider equity market.
While over longer time periods the performance of REITs can be highly correlated to the real estate assets they invest in, in the shorter term broader equity markets can dictate REIT share prices.	

Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise as a result of market fluctuations and you may not get back the amount originally invested.

Glossary

Correlation: How far the price movements of two variables (eg, equity or fund returns) match each other in their direction. If variables have a correlation of +1, then they move in the same direction. If they have a correlation of -1, they move in opposite directions. A figure near zero suggests a weak or non-existent relationship between the two variables.

Diversification: A way of spreading risk by mixing different types of assets/asset classes in a portfolio. It is based on the assumption that the prices of the different assets will behave differently in a given scenario. Assets with low correlation should provide the most diversification.

Dividend yield: The income received on an investment relative to its price, expressed as a percentage. It enables comparisons of the level of income provided by different investments such as equities, bonds, cash or property, or between funds at a point in time.

Leverage: The use of borrowing to increase the allocation to an asset/market. This can be done by borrowing cash and using it to buy an asset, or by using financial instruments such as derivatives to simulate the effect of borrowing for further investment in assets.

Liquidity: The ability to buy or sell a particular security or asset in the market. Assets that can be easily traded in the market (without causing a major price move) are referred to as 'liquid'.

Risk-adjusted return: Expressing an investment's return through how much risk is involved in producing that return.

Volatility: The rate and extent at which the price of a portfolio, security or index moves up and down. If the price swings up or down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. It is used as a measure of the riskiness of an investment.

At a glance

- ✓ REITs are a simple and cost-efficient way to add an allocation to property in an investment portfolio
- ✓ REITs own buildings, lease space to tenants and pay the majority of rental income to shareholders
- ✓ REITs can enhance portfolio diversification, potentially improve risk-adjusted returns and provide a steady stream of income
- ✓ Listed REITs are subject to both market fluctuations but also weakness in the underlying real estate assets
- ✓ REITs generally carry higher risk than most bonds

Glossary

Please see https://www.janushenderson.com/en-gb/investor/glossary/ for a glossary of financial terms used in this document.

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