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ASK THE **ADVISERS**

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Public REITs are Undervalued

By investing in publicly traded REITs, investors can get exposure to a diversified portfolio of professional managed commercial real estate. Because these REITs are publicly traded, they tend to do well when the stock market is doing well and do poorly when the stock market is doing poorly.

This year through mid-December the Vanguard REIT index (VNQ) is down over 23% versus negative 15% for the S&P 500 index. By contrast to its public counterpart, private real estate, most notably Blackstone's BREIT (the largest private REIT), is up 9% this year. Private REITs always sell based on their net asset value (NAV) without a premium or a discount.

In the beginning of January, Public REITs were trading at a 14% premium to the NAV of the underlying real estate owned by the REIT. When interest rates shot up earlier this year, public REITs fell sharply while pricing in an anticipated major downturn for real estate. Public REITs fell so much that by July they were trading at a 19.4% discount to the NAV.*

Over the last 25 years, there were 8 instances where public REITs traded at a discount of more than 15% and the average total return following such a steep discount was 33% after one year and 62% after 3 years.

The one exception being in August of 2007 during the mortgage crisis. At that time REITs were over leveraged with debt rates of about 46%. In order to deleverage, public REITs needed to issue additional shares and use the proceeds to reduce debt which diluted share value.

That is not the case today as public REITs only have about 29% leverage. Is it risky to buy REITs right now? I would submit that it is generally less risky to invest in an asset class after it has lost 25% in value and trading a substantial discount to its NAV than investing in an overpriced asset class that is trading at a premium.

*Advisor-Access.com

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