Real Estate with Andrew Rubin

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Why do you consider real estate an attractive place to invest?

We believe that the primary potential benefits of investing in commercial real estate securities — diversification, income and liquidity — make inclusion of the asset class in investors’ portfolios critical in any market environment.

Real estate investment trust (REIT) stocks have performed very well recently. With U.S. economic growth accelerating, demand is rising for all types of commercial real estate, including office, retail, warehouse, and others. At the same time, new construction of commercial real estate remains below historical averages. In other words, supply is lagging demand, which helps keep occupancy levels and rents high. A unique feature of REITs is their potential to pay out steady and relatively high dividends. When interest rates are low, as they have been for the past few years, this can be very attractive to investors. We’ve seen increased interest in real estate from those seeking higher yields than are available in other areas of the market — a phenomenon that could persist.

Finally, despite recent strong performance, REIT valuations remain reasonable, particularly relative to the value of their underlying real estate properties, which have been increasing steadily for several years.

How would REITs be affected if U.S. interest rates should rise?

If history is any indicator, the impact would likely be minimal over the long-term. Many investors are worried about rising interest rates, and it’s true that commercial real estate, as a capital-intensive industry, can be affected by higher rates as REITs must pay out most of their cash flow in the form of dividends, which requires them to continually access capital markets for funds to acquire and develop properties. Higher interest rates equate to higher borrowing costs for REITs. However, there is a positive side to rising rates in that this generally portends strong economic growth, which is good for commercial real estate. Rising economic activity has historically translated to rising demand for all types of commercial space. Overall, historical REIT performance has shown very little correlation to interest rates over the long-term.

What attractive investment trends and opportunities do you see?

We’re finding some interesting opportunities in companies with exposure to downtown office markets in large gateway cities. Building tends to be more difficult in downtown areas, because land is more expensive and construction costs are higher. This can help keep supply growth below demand, supporting higher occupancy and rents. Another
area where we've been seeing opportunity is among REITs that are candidates for restructuring. Historically, this has been a relatively minor theme in the REIT world. But activity has begun to pick up over the past year or so as we've seen a surge in activist investors in the market and because it's relatively easy to ascertain the value of REITs' underlying assets compared to other sectors. If a REIT's shares are trading at a significant discount to its properties' net asset value over time, and management appears to be doing nothing to close the gap, it may become a target for activism. Ultimately, it could be taken private, merge with another REIT, or spin off assets to focus on maximizing value from its core assets. Any of these actions could potentially reward investors.

For more information about our current views of the real estate industry, please see our recent State of the Sector piece on real estate. Thank you.

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A security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages. A REIT is required to invest at least 75% of total assets in real estate and distribute 90% of their taxable income to investors. Stock markets are volatile and can fluctuate significantly in response to company, industry, political, regulatory, market, or economic developments. Investing in stock involves risks, including the loss of principal. Illiquidity is an inherent risk associated with investing in real estate and REITs. There is no guarantee the issuer of a REIT will maintain the secondary market for its shares and redemptions may be at a price which is more or less than the original price paid. Changes in real estate values or economic downturns can have a significant negative effect on issuers in the real estate industry.

In general the bond market is volatile, and fixed income securities carry interest-rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.

Fixed income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Any fixed income security sold or redeemed prior to maturity may be subject to loss.

Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.
Past performance and dividend rates are historical and do not guarantee future results.

Investing involves risk, including risk of loss.

All indexes are unmanaged, and performance of the indexes includes reinvestment of dividends and interest income, and, unless otherwise noted, is not illustrative of any particular investment. An investment cannot be made in any index.

Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments.

Because of its narrow focus, sector investing tends to be more volatile than investments that diversify across many sectors and companies. Sector investing is also subject to the additional risks associated with its particular industry.

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