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REITs have the potential to reduce risk and increase returns in an investment portfolio

SA REITs (Real Estate Investment Trusts) have delivered higher total returns than other asset classes over 10 years. In addition, they also represent lower risk over 10 years.

Mark Stevens, SA REIT Association Marketing Committee Chairman, notes that REITs are structured to be lower risk investments and, furthermore, most have clearly defined investment strategies specifically designed to mitigate risk and optimize investor value.

When it comes to managing risk, REITs start with a diverse portfolio of properties.

“Most SA REITs are diversified across various types of commercial property, like offices, malls, warehouses, factories, hotels and even apartment blocks. These properties are often spread across different cities and provinces. They can also be spread across different grades of property,” says Stevens. “Moreover, their income comes from numerous leases with creditworthy tenants that expire at different times.”

This means that if one sector, region or lease underperforms, its effect is muted because the other investments in the portfolio bolster performance.

Stevens explains that, like all stocks, REIT shares will fluctuate in price. But, capital growth isn’t the only benefit to a REIT investment. The total return that REITs create for investors comes from both the capital growth of its properties and regular dividends which REITs pay out from a significant portion of their profits. And, both generally keep pace with inflation.

In South Africa, REITs must pay at least 75% of their taxable earnings available to investors as dividends each year, giving investors certainty that net income will be distributed. Many pay out even more; most pay almost 100%.

A REIT’s growth in dividends comes from the growth in rental from its property assets, thanks to escalating leases. These leases make it relatively easy to predict
future earnings for investors and provide a relatively stable income stream, which adjusts upwards annually thanks to built-in escalations - currently around 8% on average for commercial property.

For investors, risk is mitigated by being able to trade out of listed REIT shares quickly. Investors can also spread risk by investing in multiple REIT companies, rather than holding a single direct property asset.

Risk is further mitigated because listed REITs are regulated by legislation which requires excellent governance and reporting. REIT directors are accountable to the JSE or FSB, depending on how each REIT is structured, as well as auditors and other external verifiers of performance.

“The South African REIT dispensation also restricts how much gearing, and the minimum level of retained funds, a REIT may have,” notes Stevens. “This provides investors with a good level of comfort that this risk is well managed.”

The SA REIT Association represents South Africa’s listed REIT sector. SA REIT members comprise all listed SA REITs and represent around R250 billion worth of real estate assets. The quality of these SA REITs influences our economy and the quality of people's lives. REITs may be part of investment portfolios for a broad range of investor types and are most suitable to investors who want exposure to property investments, without the large initial capital outlay.

“REITs’ unique characteristics make them a great investment portfolio diversifier. They combine the liquidity and accessibility of investing in the stock market with the stability and tangibility of owning real estate, and provide the potential of reduced portfolio risk with increased portfolio returns,” says Stevens.

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