Private REITs: A Reliable Choice

A real estate investment trust, or "REIT", is a corporation that owns and manages a portfolio of income producing real estate. REITs were created in the 1960s to allow all types of investors access to large, institutional quality investments that historically had only been available to a select group of participants.

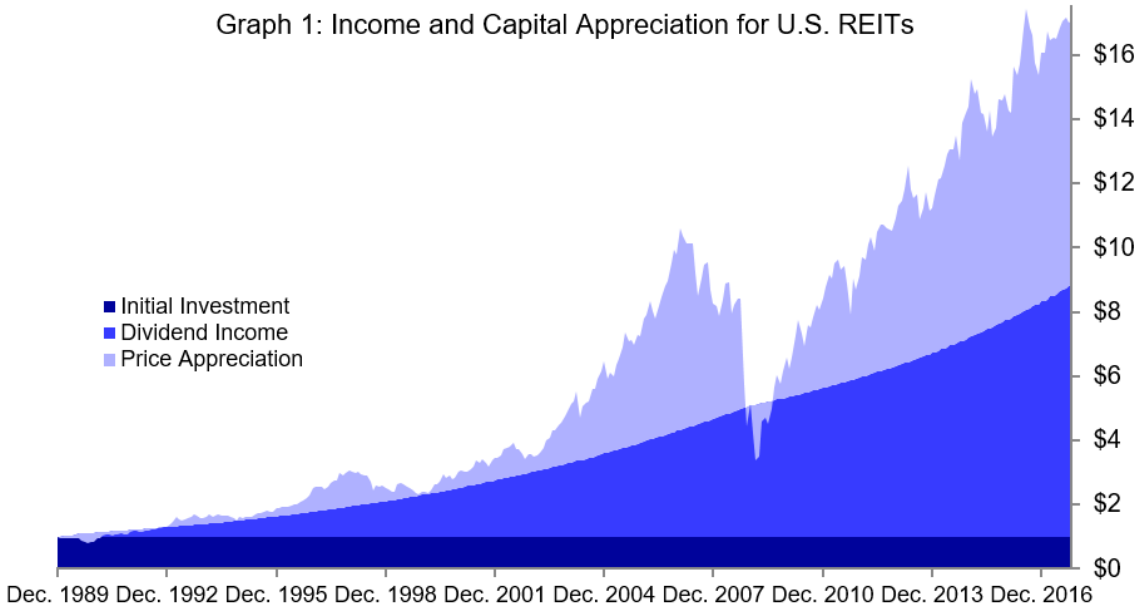
> *"Because of the strong dividend income REITs provide, they are an important investment both for retirement savers and for retirees who require a continuing income stream to meet their living expenses. Their dividends are fueled by the stable stream of contractual rents paid by the tenants of their properties."*
>
> *National Association of Real Estate Investment Trusts (REIT.com)*

REITs pay relatively high dividends compared to other stocks and have the potential for long-term stock appreciation. Their comparatively low correlation to stocks and bonds makes them a good portfolio diversifier, to reduce overall portfolio risk and increase returns. REITs are required to pay out, in the form of dividends, at least 90 percent of their taxable income annually. In most cases, REITs are paying out in excess of the required minimum and therefore a portion of the dividend is considered a return of capital and not taxable. Since REITs are pass-through businesses, 20 percent of their income is eligible for deduction against other investor income, per the recently passed tax reform act.

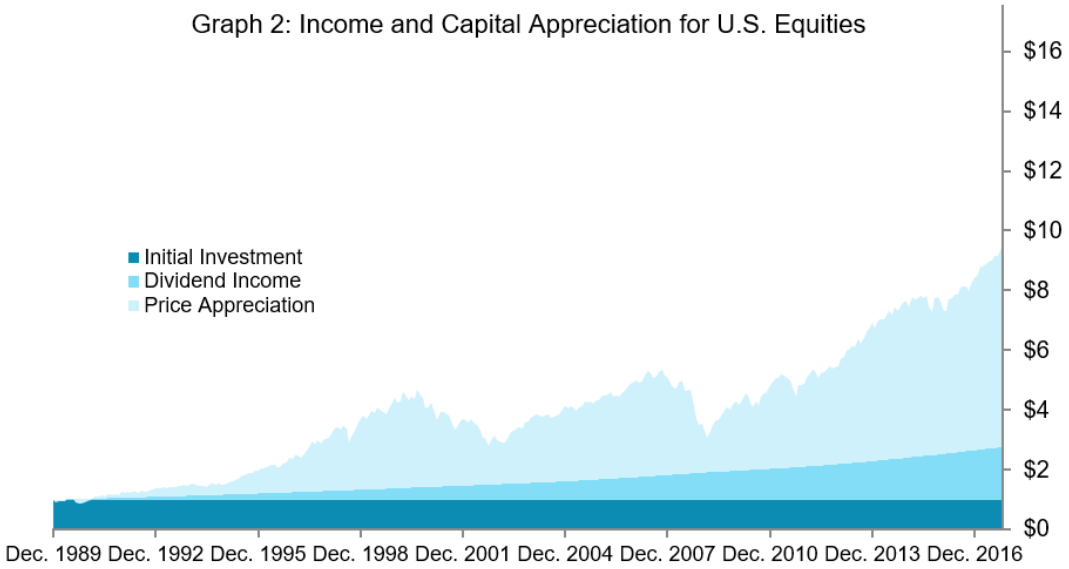
Graph 1 is the FTSE Nareit All Equity REIT Index and Graph 2 (next page) is the Russell 3000 Total Market Index. Equity REITs outperformed the broad market, primarily due to the payment and reinvestment of dividends.

The referenced article is found at: https://www.reit.com/news/blog/market-commentary/enjoy-some-steady-income-your-price-appreciation

REIT dividend and share price growth are primarily driven by net operating income growth through higher occupancies, higher rents, lower expenses and accretive acquisitions and developments. Generally, the larger the portfolio the lower the risk from tenant departures or adverse market changes. Professionally managed REITs by experienced operators are good at creating value for their shareholders.



Graph from Nareit, 11/29/17 article by Brad Case.



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The primary advantages of investing in a REIT versus investing directly in ownership of specific real estate assets are:

- Access to a more diverse portfolio of larger, and perhaps higher quality, properties than one could buy on his/her own.
- More consistent dividend income from larger pool of properties and tenants.
- Risk is limited to your investments — no capital calls, no guaranteeing loans.
- Management responsibilities in the hands of full-time qualified professionals.
- Liquidity through the REIT's redemption policy.
- Tremendous flexibility for succession planning.

Private REITs

Like most privately owned companies, private REITs are exempt from registration with the Securities and Exchange Commission (SEC) and their stock is sold directly to investors. In contrast, public REITs must register with the SEC and their stocks trade on a public exchange, such as the NYSE or Nasdaq. A private REIT is owned by individual investors who meet certain suitability requirements.

Private REIT share prices are typically valued by their Board of Directors or through an independent valuation process quarterly, semi-annually or annually. The value is based on the current and future income generating potential of the REIT's portfolio. Contrast that to publicly-traded REITs whose shares are subject to minute to minute variations in investor sentiment and vulnerable to broader equity market shocks. That exposure to the broader equity market adds an additional layer of risk that does not come with a private REIT.

The stock markets are at all-time highs and subject to rapid change. Commercial real estate fundamentals are as good as they have been in decades. Banks and money market funds have historically low interest rates on their investment products (less than 1 percent). Private REITs own stable real estate, are not subject to volatile price swings and pay attractive, reliable dividends (4 percent - 6.5 percent).

What to Look for in a Private REIT

When choosing a private REIT there are a number of factors to consider. As with many decisions, it starts at the top. Look for companies with experienced and reputable management teams. How long have they been in the commercial real estate business? What is their reputation amongst other owners, bankers, agents? Are they experienced in the type of real estate

the REIT is acquiring? Do they know the markets in which they are investing?

While past performance is no guarantee of future performance, it is important to consider a REIT's historic returns. How do those returns compare to the overall market? Have the returns been consistent or do they fluctuate wildly? Are the returns coming through dividends, increases in the share price, or both? Do they charge fees or not to invest?

It's important to understand the REIT investment strategy. Ask the following questions: Is the investment approach clearly articulated and justified with sound underwriting and analysis? Does it make sense in light of current and future economic trends?

Other important questions to ask include: How well are the interests of management aligned with those of the investors? Has the management team put in place the appropriate accounting and audit controls to protect investors? Does the REIT send regular financial reports with an appropriate level of detail? Is the management team accessible if you have issues or questions?

When compared to investing in public companies, investing in private companies can require additional work to find the answers you need to make a smart decision. That said, private companies, and private REITs in particular, can offer investors the opportunity to create tremendous value.

Summary

Investing in real estate investment trusts (REITs), whether public or private, provides non-correlated investment diversification from the stock and bond markets. Investors with real estate in their portfolio mix do better than those that do not. Private REITs pay attractive dividends in this yield-starved environment, and that is not going to change much. They also deliver steadier long-term capital appreciation. Private REITs are a solid play for investors concerned about preservation of capital, consistent dividend payments and long-term value growth.

About the Author

Mark W. Reiling is President of Minneapolis, MN based SR Realty Trust, Inc. (www.srrealtytrust.com). Mark has nearly 40 years of commercial real estate investing, finance, development, sales, leasing, management and consultation experience. Prior to joining SR Realty Trust, Mark was Chief Investment Officer for Investors Real Estate Trust (NYSE: IRET), and President of Colliers Towle Real Estate Company. Mark holds a BBA in finance from the University of Notre Dame and the CRE and SIOR designations. He serves on the boards of Sunrise Banks and The Goodman Group, and is a member of the Urban Land Institute and NAIOP.

About SR Realty Trust

SR Realty Trust, Inc. is a private real estate investment trust, or REIT, formed on September 15, 2014 for the purpose of investing in a diversified portfolio of commercial real estate properties and other real estate related assets. Our portfolio consists of various types of commercial real estate property, including industrial, retail, multi-family residential and single-tenant net leased properties. As of December 31, 2017, SR Realty Trust owns over $100M in assets.

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