

Markets & Finance

Personal Finance

REITs Lure Investors Seeking High Yields

- ▶ Trusts that own apartments have been particularly hot
- ▶ They “require faith that businesses are going to be profitable”

For the past 10 years, through two recessions, Michael Agran has dedicated 20 percent of his investment portfolio to real estate investment trusts. The Los Angeles tax lawyer has no plans to diminish his stake even as the prospect of an economic slowdown looms. “If there’s a recession, where am I going to put my money?” Agran says. “Am I going to put it in the bank and earn a quarter of a percent a year? Not going to do that.”

That’s a common refrain in this era of near-zero interest rates. People have piled into REIT stocks because they are “so starved for income,” says Larry Glazer, a managing partner at **Mayflower Advisors** in Boston. One indication: Investors have added a net \$3.7 billion to mutual funds that invest in U.S. real estate investment trusts this year, the most new money since 2006, according to a Citigroup Global Markets report. At the same time, they withdrew about \$70 billion overall from funds that invest in domestic stocks, according to estimates from the Investment Company Institute. “REITs are attracting attention because of their income, the dividend yield, and the fact that REITs do own hard assets, which offer inflation protection,” says Philip Martin, REIT strategist at research firm Morningstar. So far this year, REIT stocks have declined 2 percent as of Sept. 12, according to the Bloomberg REIT Index, compared with a drop of 7.6 percent for Standard & Poor’s 500-stock index.

Most REITs are publicly traded companies that own and operate property including apartments, offices, retail space, health-care facilities, and hotels. They must distribute at least 90 percent of their taxable income to shareholders annually in the form of dividends. The securities had an average dividend yield of 3.7 percent as of Sept. 12, according to the Bloomberg REIT Index of 129

publicly traded property owners. That compares with yields on 10-year Treasury notes of 1.95 percent as of Sept. 12, and 0.02 percent for the average taxable money-market fund as of Sept. 6, according to research firm iMoneyNet. Moreover, those yields are expected to climb by 4 percent to 6 percent annually for the next several years, according to Martin, in line with their average annualized dividend growth rate of 5.8 percent the past two decades.

People convinced that the U.S. is “at the beginning of a horrible recession” should be wary of REITs because a slump would weaken demand for commercial space, increase vacancies, and limit cash flow at income-producing properties, says Ralph Block, author of the *Essential REIT* newsletter. The national vacancy rate for office buildings was 17.5 percent in the second quarter, according to REIS, a real estate data firm. Investing in REITs “requires faith that businesses are going to be profitable, they’re going to want to grow, they’re going to want to take more space,” Block says.

Another consideration is whether investors have bid up REIT stock prices to the point where there’s little potential for appreciation, says Sam Katzman, chief investment officer at **Constellation Wealth Advisors**. According to Morningstar’s analysis, apartment REITs are among the more “overvalued,” says Martin. Demand for apartments has soared in the U.S. as home foreclosures forced people out of their

residences and prospective buyers have found it harder to get mortgages. **Equity Residential**, the largest publicly traded apartment REIT in the U.S., with a yield of 2.45 percent, has gained 15 percent this year through Sept. 13. **Avalon-Bay Communities**, the second-biggest multifamily housing owner, has gained 18 percent; it yields 2.78 percent.

Since 1974, REITs generally have outperformed other assets, including gold, during periods of high inflation, data from the National Association of Real Estate Investment Trusts show. Yet REITs don’t protect a portfolio in all types of inflationary environments, says Robert Greer, product manager of Pacific Investment Management’s Real Return business, a series of funds and strategies designed to protect against inflation. “REITs may not protect you from inflation caused by a rise in food and energy prices,” he says, “especially if caused by a constraint in supply.”

Agran, the Los Angeles investor, generally sees publicly traded real estate as a good investment no matter what the economy does or where inflation goes. In flush times, REITs can raise rents; in tough times, those with access to capital can buy properties cheaply. “With real estate, it’s kind of like being in the business of making waxed fruit,” he says. “It’s there, it’s going to be there.”

—Oshrat Carmiel and Margaret Collins

The bottom line While REITs offer a healthy average yield of 3.7 percent, they could suffer if an economic slump cuts demand for office and retail space.

REITs Top Rivals for Income

Yields on real estate investment trusts have fallen since 2009 but still lead the pack

