RCGeconomics

REITView Sept 2018

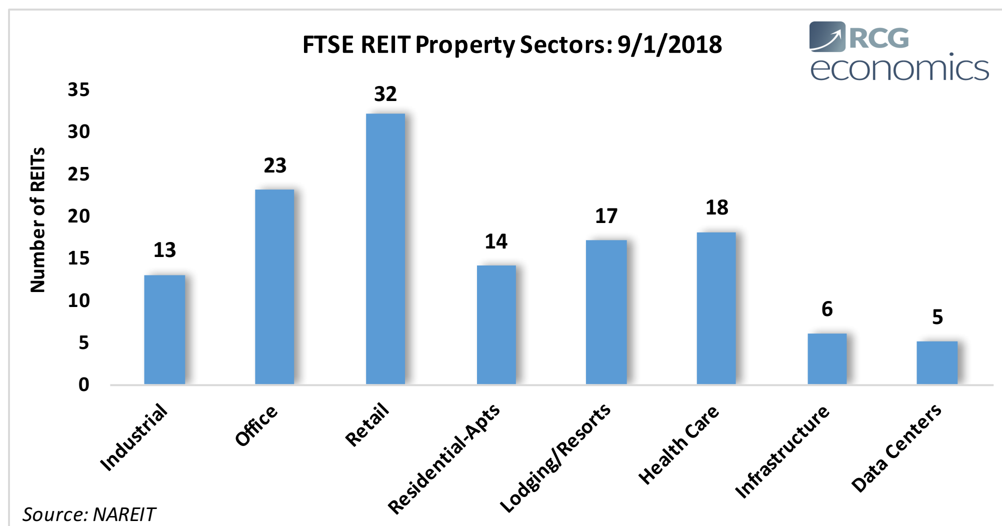
Welcome to the monthly REITView newsletter – analyzing the latest trends in real estate investment trusts (REITs) and the implications for investors and the Nevada real estate market. REITs own, and often operate, a pool of income-producing real estate assets. Investors can then purchase a liquid stake in these portfolios – think of them as mutual funds for real estate.

While REITs are not the biggest players in Nevada's commercial real estate landscape, secondary markets like Las Vegas with above-average population and job growth are likely to attract REITs looking for value and growth opportunities. According to *Raymond James*, "since the spring of 2016, non-gateway REITs have pulled ahead in total return.[1]"

REIT PROPERTY SECTORS

REIT portfolios are divided by market sector, and below is some analysis based on the most relevant sectors to Nevada.

Retail has 32 FTSE REITs[2] – the most of any sector, and the only one to add a new FTSE trust since the last edition of this newsletter. While online retail is certainly having impacts on specific brick-and-mortar companies, with ripple effects across the sector, it is still a large and robust area for real estate investment. The sectors listed below represent about 75% of the 171 FTSE REITs currently being traded.



REIT TOTAL RETURNS

It is useful to look at shorter-term and longer-term returns in various sectors to determine trends. For the year to date, Lodging/Resort REITs lead the way with 10.9% gains. However, returns seem to have slowed recently, up only about 2% over in August and for the quarter to date. A similar trend is seen in the Industrial real estate sector, with big gains over the course of the year but a recent leveling-off. It's worth keeping an eye on industrial real estate, booming in part due to the explosion in online retail fulfillment centers, in comparison to the retail sector.

Healthcare, on the other hand, has posted 9.1% gains over the year, and about 7% in August and for the quarter to date. This tracks with the consistently growing demands for healthcare services as the large Baby Boomer generation ages. Infrastructure was the poorest performer in August, with 1.4% growth, while office REITs are faring worst for the quarter and year to date. In Las Vegas, office vacancy rates in some submarkets and classes have been stubbornly high, exerting pressures on rents and returns.

Another interesting trend to note is that all REITs are now positive for 2018 to date, while just a few months ago most were seeing losses for the year. This may be a correction of concerns about the possible effects of rising interest rates on returns.

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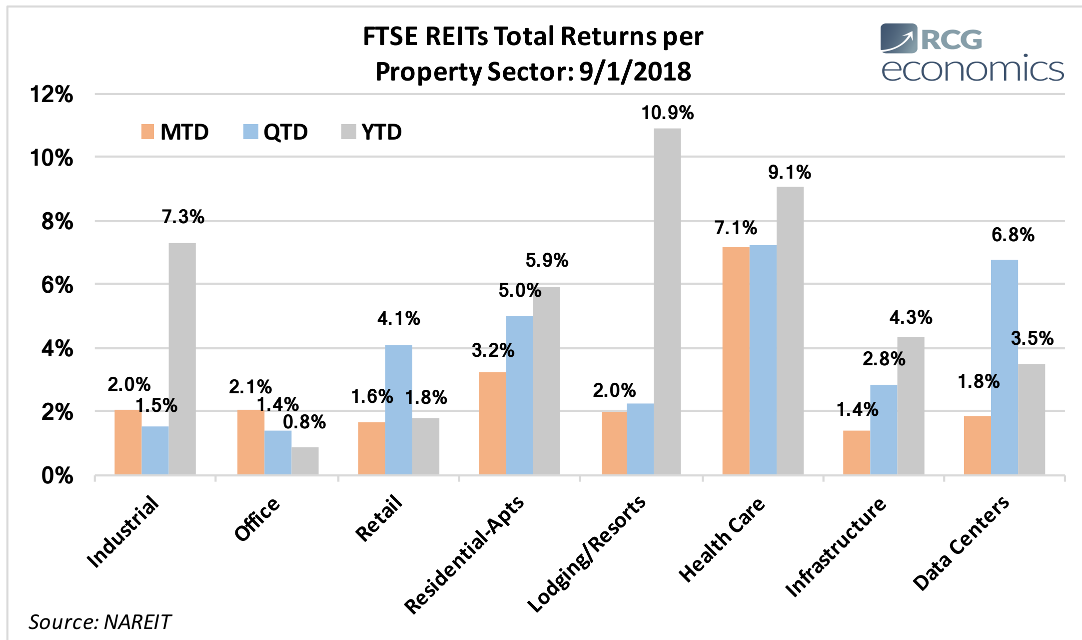
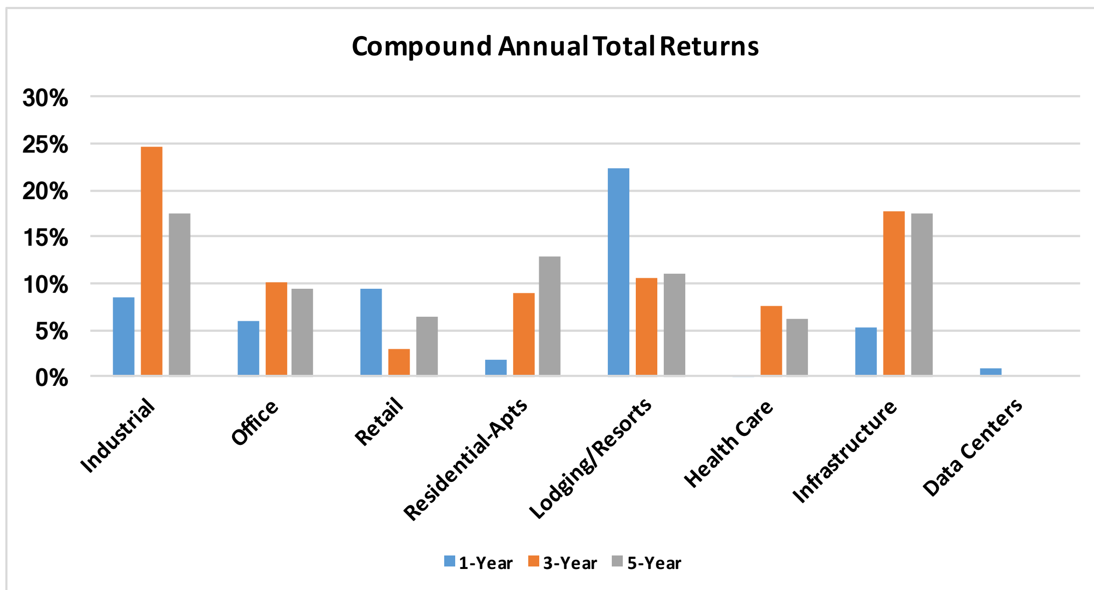
[1] *http://www.raymondjames.com/forefront/real-estate/text/non-gateway-reits-offer-new-horizon-for-investors*

[2] *REITs that are tax-qualified and can be found on the New York Stock Exchange, the American Stock Exchange, or the NASDAQ.*



Looking even longer-term, at compound annual total returns, we see that infrastructure and industrial REITs are performing the best over a 5-year period, each with gains of about 17%. Industrial is the best performer in the 3-year period at almost 25% growth, consistent with commentary above about the rapid expansion of online retail fulfillment. Looking to retail, there may be a brighter or at least more stable outlook on the horizon. Relatively weak retail performance over the longer term is met with almost 10% returns over the last year, the second-best of any of the selected sectors. Healthcare also stands out with notably flat returns over a 1-year time frame, despite solid if modest returns over 3 and 5 years.



CONCLUSION

As predicted in the last edition of this newsletter, strong monthly and quarterly growth correctly pointed to positive trends that brought sectors out of the red for the year to date. While industrial growth has been strong for some time, it may be leveling out as more space is completed and meets the demand created by changes in technology. That said, further shifts could continue to push acceleration in this industry and weaken recent recovery in retail.

Also, the Tax Cuts and Jobs Act contains a 20% deduction on pass-through entity income. That's a direct benefit for REITs according to Daniel Milan of Cornerstone Financial Services[3]. We may have seen that benefit priced into recent REIT gains over the last quarter.

[3] https://money.usnews.com/investing/real-estate-investments/articles/2018-02-02/3-reasons-to-revisit-reits-in-2018