

STRATEGY

No such thing as a free lunch, even with private REITs

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Real estate investment trusts have been hot in recent years as yield-hungry investors chase these securities for their healthy dividends.

But higher-net-worth individuals can also invest in private REITs, which similarly own properties ranging from apartments to shopping malls, and may even provide a higher yield than their public peers.

The big pitch for these alternative offerings is that their unit prices don't fluctuate as much as their public cousins. The wild swings in REIT prices were evident in 2008 when the sector crashed along with the broader market. The S&P/TSX Capped REIT Index plunged nearly 40 per cent.

"The market decides what [a public REIT] is worth on a minute-by-minute basis," says David Kaufman, president of Westcourt Capital Corp., a consulting firm specializing in alternative investments. "Private REITs are less volatile."

The unit price of a private REIT doesn't move in tandem with equity markets because it is based on the appraised value of the properties, which is typically updated quarterly. When investors want to withdraw their money, they get the stated net asset value (NAV) per unit at the time.

Memories of the 2008 market meltdown have led investors such as Sharon Black of London, Ont., to seek out alternative, non-listed investments. She now owns a private apartment REIT, which has been yielding between 7 per cent and 8 per cent this year.

"I don't want to be in the stock market, and have all the volatility," Ms. Black said.

"In 2008, we just had mutual funds. I was at the point when I used to get my bank statements, and I wouldn't open the mail ... I need to protect my capital and have a decent rate of return," she said

Dan Hallett, director of asset management at HighView Financial Group, likes public REITs, but "they've had quite a run." Shorter term, these REITs could suffer pullbacks because of "a lot stock market noise that has nothing to do with the real estate itself and the values of the properties," he said.

There is a place for private REITs in a portfolio for income and diversification, but the challenge is to find one that "passes the due diligence checks that should be done," he said.

While the low volatility of private REITs can be appealing, there is no free lunch. They can be riskier investments because they are sold by offering memorandum, a document not vetted closely by securities regulators – unlike a prospectus filed by public REITs. That opens up the potential for scams.

“They operate under more relaxed rules about transparency and reporting,” so investors should get some independent advice when considering private REITs, said John Andrews, a real estate professor at Queen’s University.

“With publicly traded REITs ... there is a whole analyst community out there that is keeping an eye on things.”

Another drawback to private REITs is that investors can’t sell the units quickly if they want or need their money. They may have to give 30 days’ notice or longer, and might have to pay redemption fees if they withdraw their funds before a set period.

On the other hand, investors can’t always get into a private REIT when they want to. Some private REITs will close themselves to new investors when they aren’t in the market for increasing their property holdings, and only re-open when they want to raise money to buy buildings.

The eligibility rules to buy a private REIT vary by province.

In Ontario and Quebec, you need to be an accredited investor (with \$1-million in financial assets, or have an annual income of \$200,000 as an individual or \$300,000 with a spouse) or invest a minimum of \$150,000.

Even then, there are only a handful of private REITs in Canada. Toronto-based Centurion Apartment REIT is sold mainly by investment advisers or “exempt market” dealers licensed to sell non-prospectus offerings. Guelph, Ont.-based Skyline Wealth Management Inc. sell its REITs directly to investors.

Its Skyline Apartment REIT is currently closed to new investors, but its Skyline Commercial REIT, launched earlier this year, remains open to investors.

Ironically, Victoria-based League Assets Corp.’s IGW REIT, which invests in mainly shopping centres and is sold directly to investors, may soon no longer be private.

League is looking at changing it to a public real estate corporation by next year, said its chief executive officer Adam Gant, who also oversees the publicly listed Partners REIT. “People today [still] like the ease of being able trade their units.”