Real Estate as an Asset Class

This article will look at various ways that one can invest into real estate.

Mike Browne, Seed Portfolio Manager will explore ***Real Estate as an Asset Class*** in this article.

Listed versus Direct Property

Investors typically access listed property through REITs (Real Estate Investment Trusts) that give liquid exposure to a diversified portfolio of income producing properties. REITs are obliged to pay out the majority (in SA at least 75%) of their rental income to benefit from not paying income, dividend, or capital gains tax on their properties – a major advantage (investors are taxed in their own hands – unless exempt through retirement savings).

Direct property typically has higher minimum capital requirements as, when compared to listed property, there are fewer investors, and each investor therefore owns a bigger stake in each property. On top of this, given the minimums, there is less diversification even in the case where a group of property investors buys a few properties. Direct property is also highly illiquid as it can take months from when a property is put on the market to when the investor receives the proceeds of the sale. In general, direct property is higher risk than listed property investing, but with the higher risks come higher potential rewards for savvy investors.

Rental versus Development Property

Most properties around the world have already been developed and are being utilized. It makes sense, then, that most real estate globally generates a rental yield for the owners of the property. Key skillsets in the property rental game are the ability to manage and maintain a portfolio of properties and vet and collect rent from tenants. REITs fall into this category, but investors can also access rental property directly and either manage the process themselves or outsource to a service provider.

Property developers (as the name suggests) buy land (either with some property already there or completely undeveloped) and plough capital to improve the real estate, with the intention of offloading it at a profit once construction is complete. Developers often have construction/project management skillsets that are an important part of the development process. Given the massive capital required to both purchase and develop real estate, this is also a higher risk way to access property (can be listed or direct – but typically direct) but the higher risk does allow for potentially higher returns should all go to plan.

Most investors will already have real estate or property as part of their asset register. For those investors that own the property they live in, a large percentage of their NAV probably already sits in property, for others there is probably some real estate held in their retirement savings or other listed investments. The optimal weighting to property will vary from each investor, and each investor will need to assess how they access this asset class.

As mentioned, while there can be no difference in the underlying asset, how you access it will have a major impact on the type of return that you can expect to generate.

Real estate is a highly emotive asset, understandably so given that everyone needs a roof over their head. Property is also a very tangible asset that can generate a predicable yield and therefore sits front of mind for investors across the world.

Real estate is a major asset class both globally and locally but most of it sits in large pension funds, unlisted commercial properties, or privately owned residential homes, and is therefore not accessible to the man on the street or in liquid pooled vehicles like unit trusts.

In the listed environment the Real Estate sector on the JSE comprises less than 1.5% of the total market cap – it's a similar percentage in global markets – and is therefore a very niche/concentrated component of listed equities. There is quite a large disconnect between real estate as an asset class and real estate as a listed asset class.

Bear in mind that each of these is essentially the same asset but packaged in different ways. Each investor will have their own preference based on their ability to stomach risk, how much liquidity they require, any income requirements, or what specific skillsets they possess.

Hopefully this article will have given you a starting point on understanding the different packages that real estate can come in.

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The Seed team remains available to assist you on your investment journey. Do not hesitate you take full advantage of our expertise by emailing any questions to investmentteam@seedinvestments.co.za.

We always welcome the opportunity to engage with you!