3 ways to invest in real estate

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Real estate is a physical ‘bricks and mortar’ investment where income and value are driven by rents that are paid by tenants under contractually binding leases.

The asset class can be appealing to investors because it provides a high income yield relative to other asset classes, and is often less volatile in pricing. This volatility is lowest in direct real estate ownership and highest in listed real estate investments.

Real estate may also offer the benefit of inflation hedging, as some real estate leases contain provisions for rental increases in line with inflation. In addition, some types of real estate have a low correlation to other asset classes, providing portfolio diversification benefits.

Risk-return characteristics

Real estate’s typical performance bridges the gap between fixed income and equities. Real estate can offer investors a stable bond-like payment structure with the potential for equity-like upswings in yield and capital.

Real estate ranks between fixed income and equities on the risk return scale

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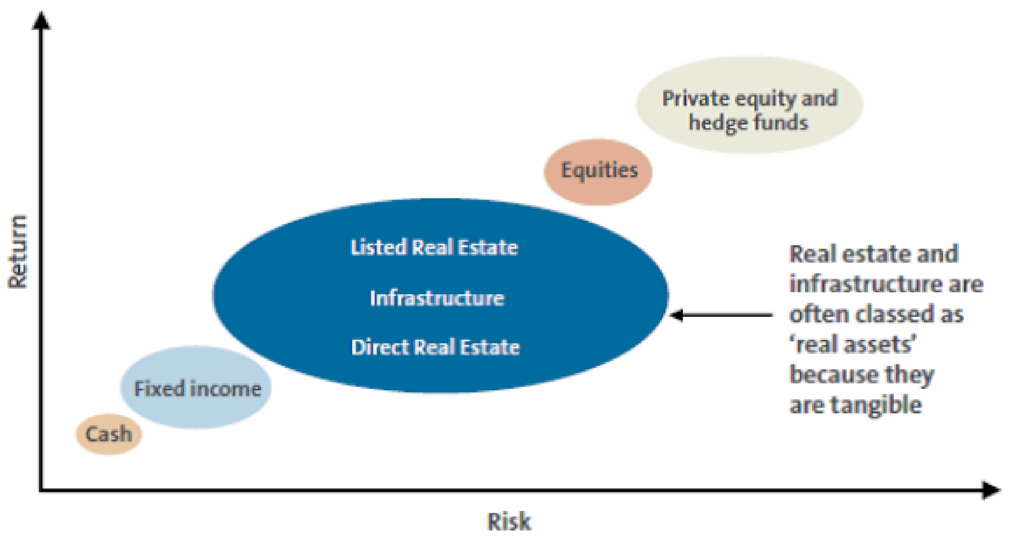

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There are a number of ways to invest in real estate:

1. Direct real estate

When investing in direct real estate, investors purchase the asset(s) themselves and gain access to the 'pure' risk of real estate. This means they can expect predictable secure long-term rental cash-flows, and exposure to the real estate market cycle, not the equity market.

Direct real estate offers relatively stable returns due to the rental payments that tenants are required to pay under leases. Major tenants typically lease space for five to 10 years. This provides investors with predictable cash-flows for an extended period of time. In addition, direct real estate typically does not trade as quickly as equities, so it prices are susceptible to investor speculation than listed real estate or equities generally.

The downside of owning a physical asset is that money has to be spent on maintaining the asset over time. However,historically direct real estate has produced relatively strong returns for investors. Direct real estate is also more illiquid (takes longer to sell) than equities and bonds. Investors seekinggreater liquidity have the option of buying listed real estate securities. However, the trade-off for higher liquidity can be greater volatility in prices compared to direct real estate ownership.

Direct real estate is usually valued once a year with the valuer aiming to capture a year's worth of events at one point in time.

Actual underlying market fundamentals and asset-specific risks are the principal drivers of direct real estate pricing. Direct real estate investment by most private investors is in residential real estate, as it is beyond the reach of most individual investors to buy an office block or shopping centre, mainly because of the higher dollar amounts required. These days, however, direct real estate is becoming more accessible to retail investors via fund products that offer access to these types of assets.

2. Listed real estate

When investing in listed real estate, the investor does not hold the title to the property, but instead owns units in a fund or trust that pools money with the money of other investors to invest in a range of real estate assets. Popular listed real estate investments are Real Estate Investment Trusts (REITs), which make up a significant part of equity markets.

One of the advantages of REITs is that they allow investment in commercial and industrial assets, something that is harder to do directly. The pricing of listed securities is driven by market sentiment and prices are considered a reflection of future expectations. Unlike direct real estate, bad news or good news is usually reflected immediately and prices can 'overshoot' on the upside and the downside.

3. Pooled Funds

Pooled funds offer a way for investors to own a partial share of a range of real estate assets, helping to spread risk and

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increase diversification.

- **Syndicates** typically invest in one or two assets, offering retail investors the opportunity to buy partial shares of physical assets with other investors.
- **Managed funds** provide a way for investors to access a broad range of underlying real estate assets. These can be in direct real estate, listed real estate or a combination of the two (known as a hybrid fund).

Managed funds add value for the investor through active management. There are significant differences between real estate markets around the world which require local knowledge. Active managers also conduct thorough research to identify the best prices for real estate investment opportunities.

To learn more about investing in real estate, including the key risks of investing, download our detailed Understanding Real Estate booklet.

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