PRIVATE REITs

The solid alternative investment option you need to know about

Private REITs can offer investors better returns and less volatility than their public counterparts. REIT manager **Skyline Group of Companies** outlines what you need to know about this investment model

Although real estate has remained a significant investment asset class for millennia, it is still considered an 'alternative investment' – meaning its characteristics differ from the traditional three broad asset classes of equities, bonds and cash. With its potentially long holding periods, real estate is often touted as an investment that can help to stabilize overall portfolio returns.

Many investors are not only forgoing traditional asset classes in favour of real estate, but are also rejecting the traditional physical ownership of multiple properties, and are instead looking to diversify their portfolios and maximize their RRSPs by investing in a real estate investment trust [REIT]. A REIT is a pool of investors who combine their equity to invest in a portfolio of income-producing real estate assets. Investors can choose from REITs that purchase across multiple asset classes (apartment buildings, industrial buildings, office buildings, shopping centres, medical buildings and resorts, to name a few), while other REITs focus on a single asset class.

WHY INVEST IN A REIT?

REITs provide a steady and generally reliable flow of income. In terms of security, apartment-based REITs are especially attractive investments, as they capitalize on the fact that shelter is a basic need. In other words: Everyone needs a place to live, whether the economy is bad (when homeowners will sell and downsize) or good (when young people can afford to move out of Mom and Dad's). Industrial commercial and office space portfolios, especially those composed of highly flexible spaces with a strong tenant mix and multi-tenant base, can also provide incredible returns with added stability.

Another distinct advantage of investing in a REIT is the expertise of the REIT's diverse management team, along with the benefits of the economies of scale that a larger portfolio can gain over a single-property owner. A REIT's management team can provide unique insight and expertise in every field of real estate investment: acquisitions, property management, tenant relations, asset management and marketing. Further, REITs can negotiate better contracts than individual retail investors for items such as waste removal and insurance, as they have a larger portfolio upon which to leverage. REITs can also more easily negotiate innovative new revenue sources, such as cable-sharing agreements, solar income and roof rental contracts for satellites – thereby providing income opportunities that would likely not be available to a single-property owner.

If those weren't enough reasons to consider investing in a REIT, one should also consider the diversification advantages that a REIT can offer, such as multiple tenants, multiple properties, a diverse tenant mix and geographic diversity. In addition, because REITs classify their returns as 'return of capital,' they have their own tax advantages.

> A well-managed private REIT understands the advantages of educating and empowering its investors

PUBLIC VS PRIVATE REITS

There are two different types of REITs. Public REITs are listed on the stock market, and are thus more correlated with the trends of the markets. Their units may be purchased without the investor needing to meet certain criteria (or 'exemptions'), and are sold through a standard document called a prospectus, which is governed under securities law.

By contrast, private REITs, which are classified in Canada as exempt market products [EMPs], are not listed on any stock exchange and are governed under their own securities law. Private REIT units can only be purchased by investors who meet certain criteria. One significant advantage of investing in a private REIT is its low correlation to the markets – the price of private REIT units is solely based on the actual appraised value of the real estate holdings, which translates to a lack of fluctuation in response to public market volatility. This class of REIT maintains a firm stance on its position as private: As real estate is a bricks-and-mortar asset that physically exists today (and will tomorrow), it is nonsensical that it should be subjected to the emotion associated with less tangible assets such as stocks.

WHAT A STRONG PRIVATE REIT LOOKS LIKE

Private REITs are often overlooked by investors as too risky due to their lack of disclosure in comparison to their public counterparts. In truth, a well-managed private REIT understands the advantages of educating and empowering its investors. When you investigate a private REIT as an investment option, here are some positive signs to look for:

1 **Management has a good track record and reputation.** Management practices are usually the greatest risk of any investment. Look for a REIT with an experienced management team that is willing to communicate its acquisition and property management strategies.

Reporting documents are provided to investors upon request. Well-established private REITs offer an open-door policy, providing significant disclosure and education to existing and prospective investors alike. Although private REITs are not required by law to publicly display their audited financials and prospectus, a favourable private REIT should provide investors with audited financial statements, annual reports and a copy of its offering memorandum (a document similar to a public REIT's prospectus, which describes the purpose of the REIT's equity raise and the facts related to the investment opportunity).

The REIT temporarily closes to new investments when it raises enough investor equity to fund new property acquisitions. Although this means that investors may not be able to get into the REIT when they want to, a temporary close in equity raising is a very good sign – it demonstrates discipline and proper management.

There are no hidden fees. One hundred per cent of the investors' capital investment should be going to work for them. Management fees (property management, asset management, wealth management, etc.) should be reasonable and fully disclosed.

The redemption policy is reasonable. Ask if there are any penalties for breaking the terms of your investment timeline (redeeming too soon), or if there are redemption fees.

The REIT's business model aligns with your investment goals. The corporate structure of the REIT should be straightforward and easily understandable. Does the REIT buy cash-flowing real estate, or does it invest in speculative developments? Which asset class is its focus?

Another qualm many investors have with private REITs is the risk of illiquidity. It's true that short-term, quick-turn investors should probably not consider private REIT investing, as private REIT units cannot be sold as quickly as those on the public markets. However, this fact falls in line with the private REIT philosophy that real estate is meant to be a long-term investment: Just as it is not meant to be on the public market and vulnerable to the volatility of the stock market, it should also be treated as a means to earn long-term cash flow. In other words, those who wish to sell in a matter of days need not apply.

With private REITs, there is no secondary market on which to buy and sell units, so careful research should be done to understand where the REIT's liquidity comes from, and if it currently has any liquidity issues. A properly managed REIT will budget for redemptions as part of its regular course of business, and your funds should be returned to you at full market value.

REIT investing allows individual retail investors a distinct opportunity to access large institutional assets that they otherwise may not have been able to acquire on their own. For sophisticated and educated investors who are interested in long-term cash flow and the stability that real estate investing provides – without the correlation to the volatile stock market – private REITs are a stable and viable investment option. ■

THE SKYLINE GROUP OF COMPANIES began in 1991, when brothers Jason and Martin Castellan and their friend, Roy Jason Ashdown, decided to own and manage rental properties in Guelph. The company has since grown exponentially, and currently manages nearly $2.5 billion in multi-residential, commercial and retail real estate. It employs more than 600 staff across the country.

WHAT: A full-service investment management organization with three private REIT clients, each of which focuses on a distinct real estate asset class. All three REITs have excellent track records of distributing stable and growing monthly cash distributions.

WHO: Retail investors purchase REIT units through Skyline Wealth Management, the exclusive exempt market dealer for the Skyline Apartment REIT, Skyline Commercial REIT and Skyline Retail REIT.

WHERE: Based in Guelph, with four corporate offices in Ontario and nearly 300 properties across Canada.

WHEN: The Skyline Group of Companies was formally launched in 1999. Its three private REIT investment products, Skyline Apartment REIT, Skyline Commercial REIT and Skyline Retail REIT, were launched in 2006, 2012 and 2013, respectively.

HOW: The Skyline Group of Companies is composed of several service companies that provide services to Skylines three REIT investment products. These services include asset management, mortgage financing, residential and commercial property management, wealth management and investor relations, and more.