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4 Major Differences Between REITs and Private Real Estate Investments Every High Net Worth Investor Should Know

Blog by Michaletz Zwief.

A REIT, or Real Estate Investment Trust, is a company owning or financing income-producing real estate. Private real estate investing is the use of private individuals' money (not a corporation's funds) to purchase privately held real estate assets, usually for meant commercial use.

Both REITs and private real estate investments are organized pools of capital invested in real estate.

REITs are often publicly traded, and therefore can be more liquid. Private real estate can have much higher minimums to invest and typically are offered to accredited persons. REITs typically have a low investment threshold, while the minimums are typically higher

for private real estate investments since there are fewer people investing per project. REITs are valued every day just like a stock, so they typically have a high correlation to the stock market. In comparison, private real estate typically has a low correlation to the public stock market. Public stock markets do not typically cause as great a shift in the value of private real estate.

Let’s dive a little deeper into each of these differences.

Correlation

One of the biggest differences between a REIT and private real estate investments is correlation to the public stock market exchanges and public offerings.

The stock market can carry risk because it’s based on perceived value of a business, its practices, and its potential probable future. Unlike real estate, you’re not typically investing in a physical asset via a stock investment. Implications of risk can be assumed due to the value of stocks and how those values can be affected by short-term fluctuations: an event outside the company’s control can cause stock prices to go up or down quite rapidly.

Since REITs, which are typically publicly traded, are heavily correlated with the stock market and potential swings in the market, it can be considered riskier to put a large percentage of your funds into both REITs and the stock market. The recommended percentage of assets to be invested into the public sector can vary widely depending on your overall goals, strategy, as well as risk profile. For example, the Harvard foundation has typically invested about 40% of its portfolio into alternatives which is inclusive of private real estate.

Due to the potential volatility in public REITs, Private real estate investment, particularly through a company that enables true diversification through a fund-type set-up, can be a great opportunity to participate in multiple investments with low correlation to the public markets. Diversifying your investments into account types not correlated with the stock market can help hedge your investments in events of market fluctuations, and private real estate can be one of those non-correlated, non-traditional investment account types.

Liquidation

The second major difference between REITs and private real estate investments is the ability to liquidate the investment if needed, i.e. cash out.

Liquidity is based on how fast you can get your money back, as cash, when wanted. Private real estate is a very illiquid investment, meaning that creating substantial returns can take a period of time. Typically, you can't sell it tomorrow at a market price; it could take a time to sell and generate targeted returns.

Think of private real estate investing like purchasing a house or a duplex: you're investing money into the property to see a return. However, when you choose to sell, it could take weeks or months to get a buyer and close on the house. You don't typically realize the cash benefits – your liquid cash – for awhile.

Since REITs are publicly traded, they operate much like the stock market; if you want to get your money back tomorrow, you're typically able to do so. It may be at a loss (based on the value of the shares you purchased in the trust), but you can get cash out quickly when you're invested in a REIT.

On the opposite side of the spectrum, there's a "liquidity cost" to not being able to get your money out quickly from a private real estate investment. Investors in private real estate are typically investing their money for an extended amount of time without having access to it. If you need cash at a certain date, you typically won't be able to tap the real estate money that's invested. Typically, for this reason, you'll often see higher returns from private real estate because of this "illiquidity cost."

For this reason, we only recommend private real estate as an investment if you can afford the illiquidity. REITs can be a better fit for your overall portfolio if you can't afford private real estate illiquidity.

Public Trading

As I mentioned before, REITs are typically publicly traded, which means they're subjected to more stringent regulatory practices and are often prohibited from investment in certain assets. By investing in private real estate, you're often in more control over what you're investing in (particularly if you choose to invest all in one property).

REITs are often open-ended, so you can buy and sell your interest freely within the REIT (similar to stocks). However, REITs are more institutional and concentrated, meaning you are often purchasing just one specific type of property, such as apartment buildings, within REITs. These is potential for REITs generate lower returns versus private real estate due to the high cost of these investments on the front end of the purchase and liquidity cost. According to our research, real estate investment trusts (REITs) perform

with an average annual return of between 8% and 11.8%. When taking an average of the last 10 years via the Dow Jones Equity All REIT Total Return Index, REITs accomplished a return of 6.4%. The S&P 500 Index's average annual return over the past 10 years is approximately 4.8%.

Comparatively, MLG Capital's private real estate investment funds target a net return of 13-15% over the length of the fund investment. Within targeted MLG Fund returns, investors are accruing to an 8% preferred return, distributed quarterly, as well as targeting the growth of underlying fund property income creating appreciation over time.

Private real estate investment firms can be picky, patient, and can find opportunities across multiple asset classes and multiple geographic locations to target higher returns. They are not prohibited from investing in assets that need more work, have an efficiency or vacancy issue creating potential, and therefore, can potentially deliver exponentially higher returns than a REIT or the public markets.

For this reason, REITs can be considered a less risky investment to some investors because they're typically investing in properties that are already high quality and don't need a lot of work; however, the returns can also be less as a result.

Minimum Investments

REITs typically have lower minimum investment thresholds than private real estate investment opportunities. Research the firms you're considering to learn about their minimum requirements and determine what makes the most sense for you financially.

Targeted Returns

The last difference I'll mention here between REITs and private real estate investment is the expected returns. This is very dependent on the firm you've selected to invest with and their approach to generating returns for their investors. For many REITs, 8-10% is a high expectation for returns on your investment. Private real estate fluctuates greatly depending on whether you're investing in a firm or in an asset directly. MLG Capital, for example, sees target returns between 13% and 15%, net to investors. Historically, MLG Capital has realized a 2.36x equity multiple over their 30 year history as a company. Simplistically, on all assets MLG Capital has bought and sold, they've turned $1 into $2.36.