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REITs: Making Property Accessible

Publicly traded property stocks, including real estate investment trusts (REITs) and real estate operating companies (REOCs), allow market participants to gain exposure to real estate, which is generally an illiquid asset class, without sacrificing the liquidity benefits of listed equities. They have also offered higher yields than other equities historically, may serve as an effective inflation hedge, and could help diversify a portfolio made up of other asset classes. In addition, index-based products, such as REIT benchmarks and ETFs that track property, may provide a cost-effective means of accessing a diversified portfolio of REITs and property stocks.

WHAT IS A REIT?

A REIT is a company that owns income-producing assets related to real estate, such as buildings, land, and real estate securities. These investment vehicles were designed to provide a structure for real estate similar to what mutual funds provide for investment in stocks. REITs were initially created in the U.S. through the Real Estate Investment Trust Act of 1960 and were intended to provide individual investors with access to a diversified portfolio of commercial real estate, an asset class formerly only accessible to large institutional investors. Through REITs, investors may participate in the ownership of major office buildings, shopping malls, hotels, apartment buildings, and other forms of commercial real estate.

To qualify as a REIT, a company must have most of its assets and income tied to real estate investment and must pay out nearly all of its taxable income to shareholders in the form of dividends. In the U.S., a REIT must meet the following four requirements.

1. The REIT must distribute at least 90% of its annual taxable income, excluding capital gains, as dividends to its shareholders.
2. The REIT must have at least 75% of its assets invested in real estate, mortgage loans, shares in other REITs, cash, or government securities.
3. The REIT must derive at least 75% of its gross income from rent, mortgage interest, or gains from the sale of real property. Also, at least 95% of gross income must come from these sources combined with dividends, interest, and gains from securities sales.

4. The REIT must have at least 100 shareholders, and less than 50% of the outstanding shares must be concentrated in the hands of five or fewer shareholders.

There are two main types of REITs: equity REITs, which purchase and manage direct investments in real estate, and mortgage REITs, which purchase loans and other debt instruments collateralized by real estate. A smaller and less significant category is hybrid REITs, which are a combination of equity and mortgage REITs.

The Evolution of REITs

The basic concept of REITs originated with the business trusts that were formed in Massachusetts in the mid-19th century, when the wealth created by the industrial revolution led to a demand for real estate investment. The first REIT was set up in 1961, but it took several decades before REITs were fully accepted as a viable asset class.

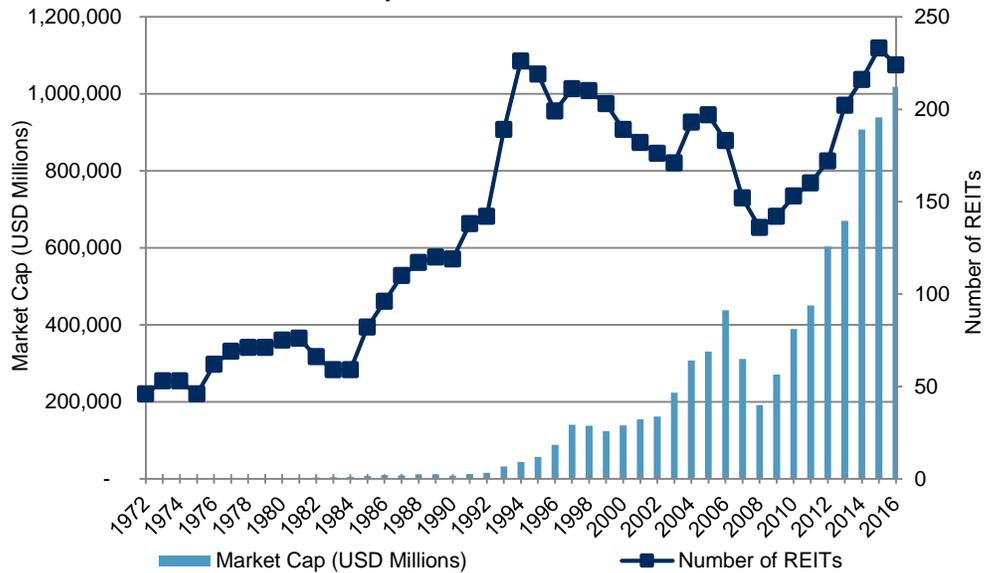
The foundation for the modern REIT market was laid in the 1980s, when the U.S. real estate market boomed and subsequently went bust. Overbuilding coupled with a reversal of a key tax shelter led to a decline in property values during the second half of the decade.

REITs have evolved into a mature asset class, with more than USD 1 trillion in market capitalization.

The decline in property values was a blessing in disguise for REITs, as it allowed them to acquire properties at cheap prices and served to buoy subsequent REIT performance. Between 1991 and 1993, the [S&P U.S. REIT Index](#) generated an average annualized return of approximately 20%.

As demand for their shares began to rise, many REITs transformed themselves from private entities to public companies in order to take advantage of attractive valuations. In fact, some of the largest REITs went public during this time (e.g., Duke Realty, Kimco Property, and Simon Property Group). By 1994, the estimated market capitalization of the U.S. REIT market had reached approximately USD 44 billion, almost six times its size in 1990. REITs have evolved into a mature asset class, with more than USD 1 trillion in market capitalization as of year-end 2016 (see Exhibit 1).

Exhibit 1: U.S. REIT Market Cap

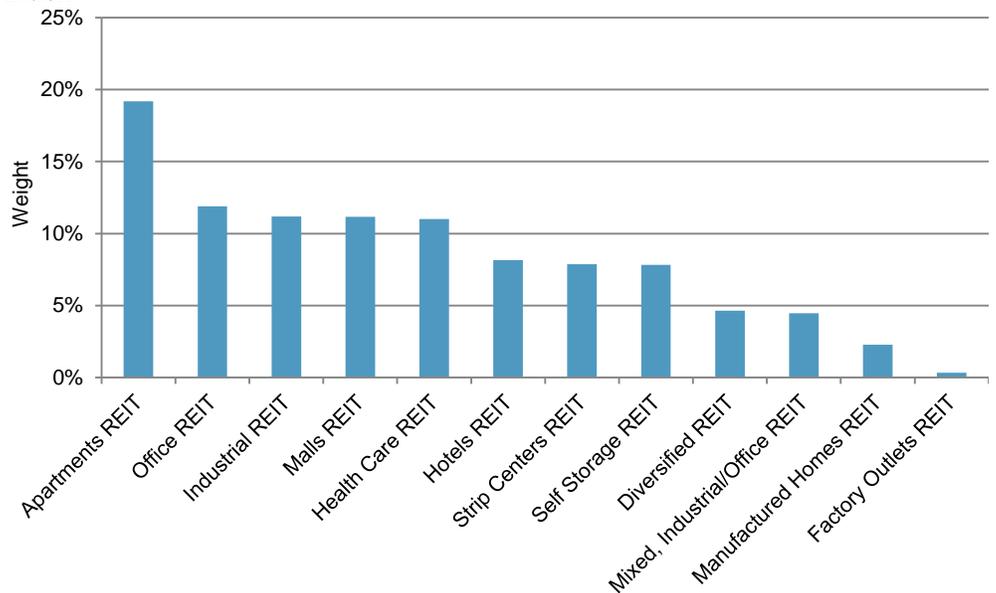


Since the IPO boom of the mid-1990s, the REIT market has continued to gain acceptance among investors.

Source: National Association of Real Estate Investment Trusts. Data as of year-end 2016. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Moreover, the breadth of the market has increased to include the 12 property sectors currently available to REIT investors (see Exhibit 2). Newer sectors include residential properties (e.g., manufactured homes), industrial properties, self-storage properties, and hotels.

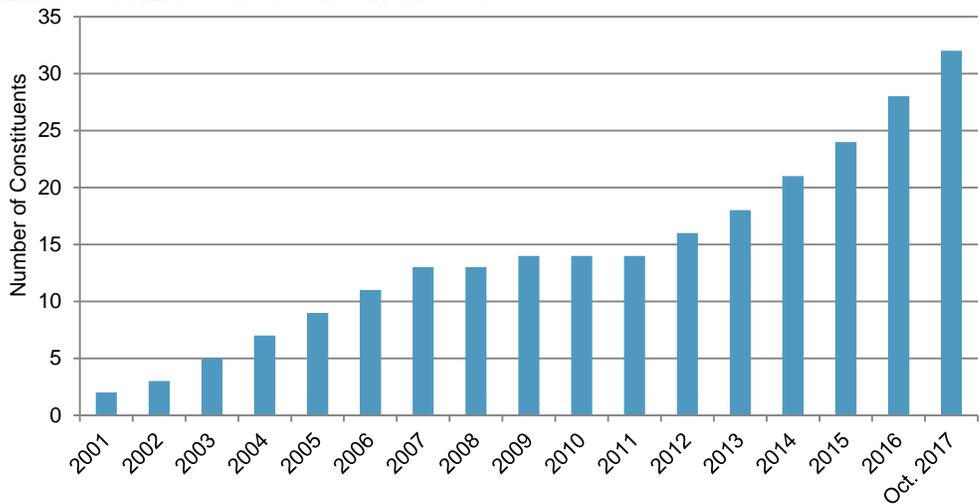
Exhibit 2: U.S. REIT Sector Weights Within the Dow Jones U.S. Select REIT Index



Source: S&P Dow Jones Indices LLC. Data as of Oct. 31, 2017. Chart is provided for illustrative purposes.

Since the IPO boom of the mid-1990s, the REIT market has continued to gain acceptance among investors. Evidence of this can be seen by looking at the increased number of REITs in the S&P 500® (see Exhibit 3).

Exhibit 3: REIT Constituents in the S&P 500



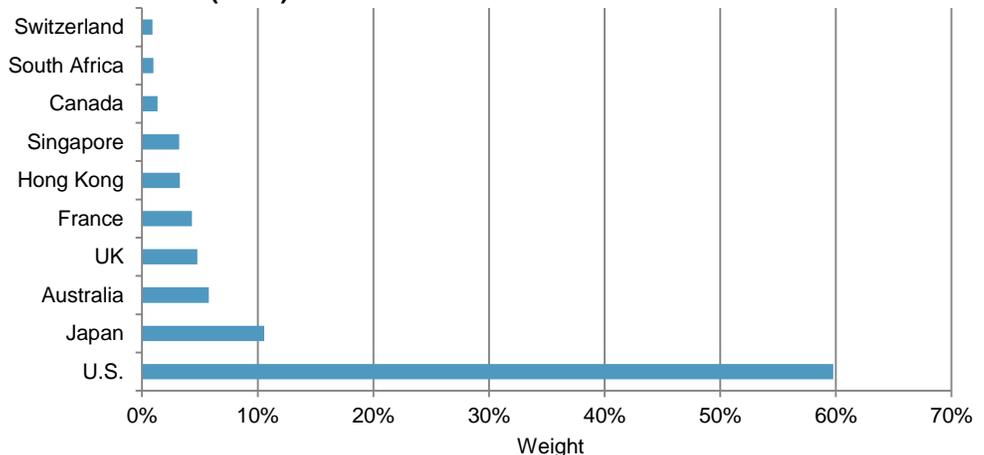
Source: S&P Dow Jones Indices LLC. Data as of Oct. 31, 2017. Chart is provided for illustrative purposes.

While the U.S. still has the largest property market as measured by the market capitalization of public property companies, Japan, Hong Kong, Australia, Singapore and the UK also have sizable markets.

In September 2016, real estate became a standalone sector within the GICS® framework, the first such change to GICS since its inception in 1999. This was viewed as a landmark moment by the REIT industry, with the recognition that REITs should form their own equity sector. REITs were elevated from their former position within the financials sector, further affirming the importance and acceptance of this asset class within the investment community.

Globally, the property market has continued to evolve. While the U.S. still has the largest property market as measured by the market capitalization of public property companies, Japan, the UK, Australia, Hong Kong, and Canada also have sizable markets (see Exhibit 4). Increased international representation could bode well for real estate investors, as the wider opportunity set may provide more chances for diversification.

Exhibit 4: Global Country Exposure – Dow Jones Global Select Real Estate Securities Index (RESI)



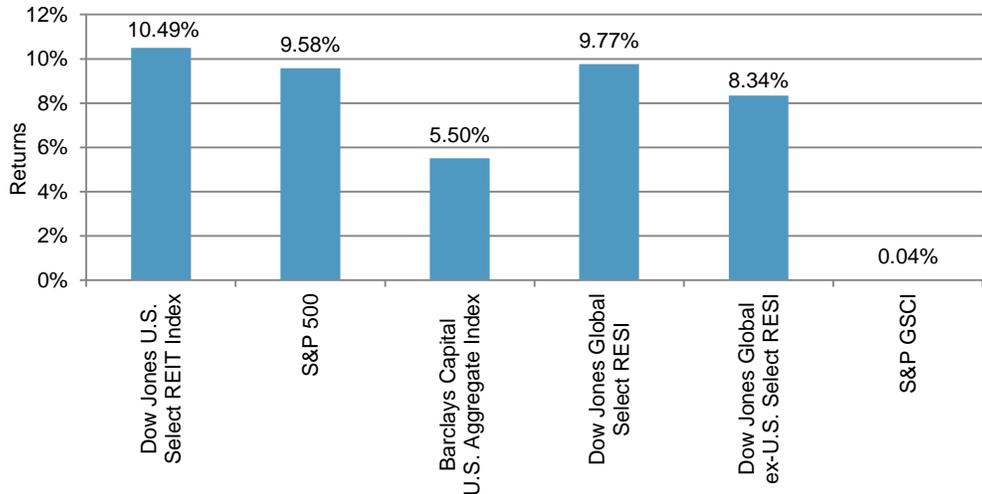
Source: S&P Dow Jones Indices LLC. Data as of Oct. 31, 2017. Chart is provided for illustrative purposes.

Returns and Risks of REITs

REIT and property stock performance has been relatively strong over the long term, especially when compared with traditional bond and equity indices. Since 1992, the [Dow Jones Global Ex-U.S. Select RESI](#) has had an average total return close to 8.3%, while the [Dow Jones U.S. Select REIT Index](#) has had an average annualized return of approximately 10.5% (as of Oct. 31, 2017; see Exhibit 5).

Exhibit 5: REIT Performance Versus Other Asset Classes

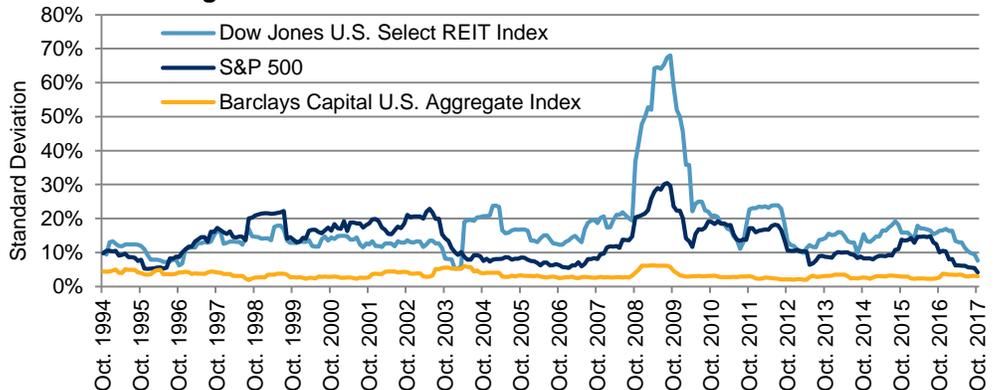
REIT and property stock performance has been relatively strong over the long term, especially when compared with traditional bond and equity indices.



Source: S&P Dow Jones Indices LLC, Bloomberg. Data from Dec. 31, 1992, to Oct. 31, 2017. Index performance based on total return. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

The standard deviation of REIT performance has been somewhat more volatile than common stocks in recent years (see Exhibit 6). This trend was exacerbated during the most recent financial crisis, as REIT shares suffered a larger and more pronounced drawdown since real estate was at the epicenter of the crisis.

Exhibit 6: Rolling 12-Month Standard Deviation of REIT Returns



Source: S&P Dow Jones Indices LLC. Data as of Oct. 31, 2017. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

REITs generally exhibit strong long-term performance characteristics, but they may provide some additional benefits, including modest correlations with other asset classes, high current income, a potential hedge against inflation, and limited investment risk.

Modest Correlations With Other Asset Classes

Correlations measure the co-movement of one asset class relative to another and can allow investors to structure broadly diversified portfolios with attractive risk/return profiles.

The correlation between the Dow Jones Global Ex-U.S. Select RESI and the S&P 500 from December 1992 to October 2017 was approximately 0.65 (see Exhibit 7). The Dow Jones U.S. Select REIT Index displayed a slightly lower correlation with the S&P 500 over this period, at approximately 0.53.

It's important to note that short-term correlations can deviate from long-term averages during periods of stress such as the most recent financial crisis. During the financial crisis, short-term correlations between REITs and stocks rose above 0.8.

REITs also may provide modest correlations with other asset classes, high current income, a potential hedge against inflation, and limited investment risk.

During periods of heightened volatility, REITs' dividend income acts as a buffer and may mitigate negative price movements.

Exhibit 7: Correlation Matrix

INDEX	DOW JONES U.S. SELECT REIT INDEX	S&P 500	DOW JONES GLOBAL SELECT RESI	DOW JONES GLOBAL EX-U.S. SELECT RESI	BARCLAYS CAPITAL U.S. AGGREGATE BOND INDEX	S&P GSCI
DOW JONES U.S. SELECT REIT INDEX	1.00	-	-	-	-	-
S&P 500	0.53	1.00	-	-	-	-
DOW JONES GLOBAL SELECT RESI	0.86	0.66	1.00	-	-	-
DOW JONES GLOBAL EX-U.S. SELECT RESI	0.61	0.65	0.91	1.00	-	-
BARCLAYS CAPITAL U.S. AGGREGATE BOND INDEX	0.18	0.03	0.22	0.22	1.00	-
S&P GSCI	0.17	0.26	0.26	0.32	0.00	1.00

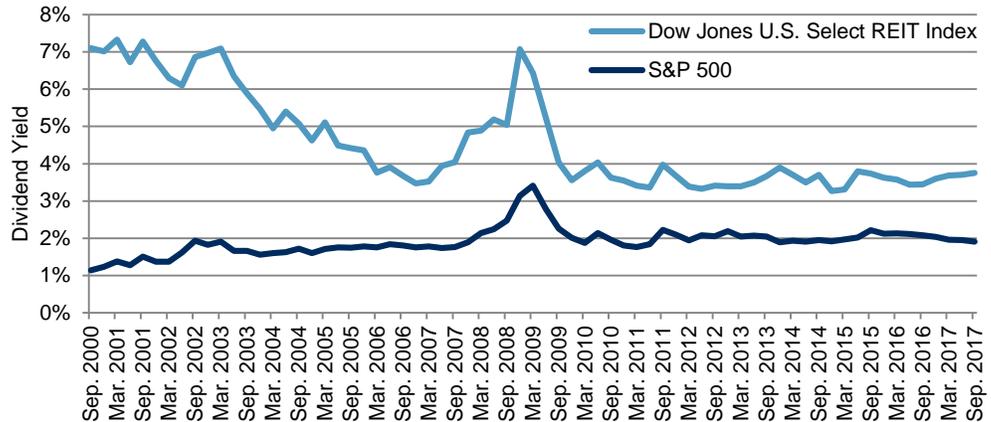
Source: S&P Dow Jones Indices LLC, Bloomberg. Data from Dec. 31, 1992, to Oct. 31, 2017. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Comparing Dividend Yields Across Asset Classes

Since 1999, approximately 40% of the total return of the Dow Jones U.S. Select REIT Index has come from dividends. During periods of heightened volatility, this income could act as a buffer and may mitigate negative price movements.

Historically, the Dow Jones U.S. Select REIT Index has produced higher dividend yields than the S&P 500 (see Exhibit 8). Since 1999, this has resulted in an additional 2.8% in yield pickup on average. More recently, the gap has narrowed to approximately 1.8%. In a low-yield environment, however, this difference remains significant.

Exhibit 8: Dividend Yields for REITs Versus Stocks

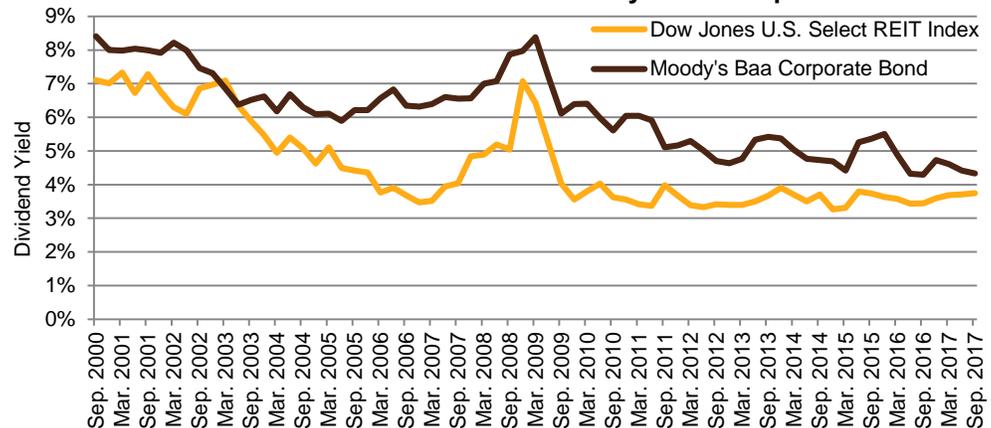


Source: S&P Dow Jones Indices LLC. Data compiled quarterly as of Sept. 29, 2017. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Bonds typically provide a promise of repayment at par, which can act as a limiting factor on both their upside and downside price movements.

Since 1999, bonds (as measured by Moody's Baa Corporate Bond) have provided approximately 1.50% higher yield than REITs (as measured by the Dow Jones U.S. Select REIT Index; see Exhibit 9). However, bonds and REITs offer different risk/return profiles. Most notably, bonds typically provide a promise of repayment at par, which can act as a limiting factor on both their upside and downside price movements. If market participants purchase bonds at par and hold them to maturity, they know in advance that the rate of return is equal to the coupon and that 100% of the total return will come from income. REITs, on the other hand, have historically generated approximately 50% of their total return from income and 50% from capital appreciation, which is why bonds are typically not considered good substitutes for REITs.

Exhibit 9: Dividend Yields for REITs Versus Moody's Baa Corporate Bond



Source: S&P Dow Jones Indices LLC, U.S. Federal Reserve. Data compiled quarterly as of Sept. 29, 2017. Chart is provided for illustrative purposes. Past performance is no guarantee of future results.

The increased breadth and depth of sector coverage in the U.S. combined with continued global expansion of property stocks and REITs has led to the development of a more robust and sophisticated asset class.

Hedging Against Inflation

Property stocks and REITs have often been viewed as inflation hedges because expected inflation will affect prices of real estate, and rental income tends to rise along with generalized inflation. However, other factors may mitigate the impact of inflationary forces. Some of these additional factors may include real estate supply and demand dynamics, interest rates, government policies, or even war. Thus, a diversified basket of assets may be necessary to properly hedge against inflation.

CONCLUSION

REITs were designed to provide individual investors with liquid investment opportunities in real estate. The increased breadth and depth of sector coverage in the U.S. combined with continued global expansion of property stocks and REITs has led to the development of a more robust and sophisticated asset class. Moreover, potentially high dividend yields, inflation-hedging attributes, and modest correlations with traditional asset classes may serve to reinforce the potential benefits of including property stocks and REITs within a portfolio context.

Exhibit 10: ETFs Linked to S&P Dow Jones Real Estate Indices

INDEX	ETF	ETF TICKER
S&P Global Ex-U.S. Property	Vanguard Global ex-U.S. Real Estate ETF	VNQI
S&P Developed Ex-U.S. Property	iShares S&P Developed ex-U.S. Property Index Fund	WPS
S&P U.S. REIT	First Trust S&P REIT Index Fund	FRI
Dow Jones Global ex-U.S. Select Real Estate Securities Index	SPDR Dow Jones International Real Estate ETF	RWX
Dow Jones Global Select Real Estate Securities Index	SPDR Dow Jones Global Real Estate ETF	RWO
	iShares Dow Jones U.S Real Estate Index Fund	IYR
Dow Jones U.S. Real Estate Index	Ultra Real Estate	URE
	UltraShort Real Estate	SRS
	ProShares Short Real Estate	REK
Dow Jones U.S. Select REIT Index	Schwab U.S. REIT ETF	SCHH
	SPDR Dow Jones REIT ETF	RWR

Source: S&P Dow Jones Indices LLC. Data as of Nov. 31, 2017. Table is provided for illustrative purposes.

PERFORMANCE DISCLOSURE

The Dow Jones U.S. Select REIT Index was launched on December 31, 1998. The Dow Jones Global Select Real Estate Securities Index (RESI) and Dow Jones Global ex-U.S. Select Real Estate Securities Index (RESI) were launched on March 21, 2006. S&P GSCI was launched on May 7, 2007. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. Complete index methodology details are available at www.spdji.com.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the Index is set at a fixed value for calculation purposes. The Launch Date designates the date upon which the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its datafeed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

Past performance of the Index is not an indication of future results. Prospective application of the methodology used to construct the Index may not result in performance commensurate with the back-test returns shown. The back-test period does not necessarily correspond to the entire available history of the Index. Please refer to the methodology paper for the Index, available at www.spdji.com for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations.

Another limitation of using back-tested information is that the back-tested calculation is generally prepared with the benefit of hindsight. Back-tested information reflects the application of the index methodology and selection of index constituents in hindsight. No hypothetical record can completely account for the impact of financial risk in actual trading. For example, there are numerous factors related to the equities, fixed income, or commodities markets in general which cannot be, and have not been accounted for in the preparation of the index information set forth, all of which can affect actual performance.

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