HEARD ON THE STREET

Real Estate Stocks Are on Sale but No One Is Buying

Listed property companies are trading at discounts to their assets, yet investors are pouring cash into private funds

Rreal estate investment trusts on average are trading a 16.4% discount to the assets they own. Above, part of the Chicago skyline. **PHOTO:** JOHN GRESS/REUTERS

By Ken Brown

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Investors hate real estate, and investors love real estate. Both statements are true right now, creating one of the oddest dichotomies in markets.

More specifically, investors hate real estate investment trusts, which have lagged behind the S&P 500 by more than 15 percentage points over the past 12 months. REITs on average are trading a 16.4% discount to the assets they own, one of the widest gaps that has ever occurred outside of a recession, according to Green Street Advisors.

But investors love private real estate funds, which don't trade on the market and so never are valued at a discount to their assets. Institutions and rich investors poured $71 billion in equity capital into private real estate funds that closed last year, according to Preqin. Private-equity firms held $1.2 trillion in real estate assets at the end of 2016, according to consultants PwC.

"There's a big pile of private capital that wants to own real estate and a big pile of real estate trading at a discount," said Jonathan Litt, the chief investment officer of Land & Buildings, which invests in REITs and has pressured some companies to take steps to eliminate the discounts.

The love-hate situation is driven by two main factors. Investors have sold REITs because of rising interest rates, which have left their yields less attractive. Meanwhile, investors also have been pouring cash into private equity, hedge funds and other alternative investments on the belief they will outperform public markets.

Yet REITs historically have outperformed similar private funds, according to Green Street. And when REITs are trading at big discounts, as they are today, they outperform by a lot.

The question is why investors would choose to invest in private funds when publicly traded REITs are on sale. The likely explanation is that investors believe private funds are less risky because their values don't bounce around like stock prices do. Risk, though, isn't volatility but rather the chance of a permanent loss of capital.

Veteran real estate investors know that the better reason for avoiding REITs is that entrenched managements often do little to close the gap such as selling properties. "There aren't enough big sellers," Green Street's Peter Rothemund says.

There are several activist investors currently waging fights to force boards to act. At Forest City Realty Trust , which owns properties in New York and elsewhere, nine of 13 board members have stepped down and the company sold some assets and ended its dual-class share structure as activists pushed it to take action. Its shares have leveled off after a six-month decline.

But the best strategy for most investors is to grab the REITs at current discounts and wait for them to shrink, as they always have. With so much private cash primed to invest in real estate, that could happen pretty quickly.

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