Q&A

Demand for new nontraded REIT products accelerating, JLL exec says

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➤ *NAV REITs, their institutional sponsors and the opening of new distribution channels will drive growth — potentially exponential growth — of the nontraded REIT market in the next few years.*

➤ *It is not particularly useful to compare nontraded REIT and listed REIT performance over short time periods, and the two should be viewed as complementary investment options.*

Allan Swaringen, CEO of JLL Income Property Trust

Source: JLL Income Property Trust

Allan Swaringen is president and CEO of Jones Lang LaSalle Income Property Trust Inc., one of the top performing nontraded real estate investment trusts over the last few years, according to data from investment bank Robert A. Stanger. JLL Income Property Trust is a net asset value, or NAV, REIT, a newer, more liquid iteration of the nontraded REIT product that is reviving the market by offering, among other things, lower fees and greater valuation transparency compared to older forms of the vehicles.

S&P Global Market Intelligence caught up with Swaringen to discuss market trends and JLL Income Property Trust's late-cycle investment strategy. What follows is an edited transcript of that conversation.

S&P Global Market Intelligence: You have 35 years' experience in real estate. I thought we could start with your big-picture view on how the nontraded REIT market has changed in recent years.

Swaringen: The legacy nontraded REIT product, with its $10 fixed share price, nonexistent or infrequent valuation, and very high fees, survived a long time, distributed almost exclusively via independent broker/dealer channels. They never really gained meaningful exposure to the registered investment adviser, or RIA, and wirehouse broker channels. And between recent regulatory changes around fees and the evolution of the products themselves over the last few years, that model is just about extinct. I don't think that's a bad thing, because I think the new products are offering much better value.

When we entered the market in 2012, we weren't trying to offer a better nontraded REIT, per se. We wanted to deliver, as closely as we could, the underlying performance of real estate — quite similar to an open-end fund. We aimed for diversified investments, across geographies and property types, with regular valuations, much lower fees and a perpetual strategy. Unlike a legacy nontraded REIT, we weren't playing to a liquidity event or other exit. But it happened that the optimal structure for this strategy was still a nonlisted REIT.

In 2012 and 2013, as one of the only NAV REITs, it was a lonely existence, and we have had to do a lot of education and outreach. But the market has come around.

So the NAV REIT field is no longer as lonely a field. Would you elaborate on that?

We've seen high-quality institutional players with sterling track records come to the space and replicate what we started in 2012. All of us continue to raise capital in the independent broker/dealer channel, but now the two other channels that were closed to fixed-price, high-commission products — the RIAs and the wirehouses — are open to the market, paving the way for many new investors and advisers. I'm quite optimistic about the growth opportunity.

Has there been an acceleration of demand as these new channels opened?

It's obviously grown, but I think there is potential for exponential growth now that we have new institutional players and there is a track record for investment performance and not merely capital raising. People can now underwrite and come to the conclusion on their own that this model works.

Still, there is a lot of education that needs to be done to make the case for this kind of real estate investment. There's some 300,000 to 350,000 financial advisers in the U.S. One firm can't do all that work, so we're thrilled to see others enter the space. It seems like a rising tide lifts all boats scenario. And the RIAs and wirehouses, most of whom now are either offering these products or are taking a hard look at them, have opened up whole new swaths of the financial adviser universe.

Recent data show NAV REITs have outperformed listed REITs recently. What's your read on that data?

I think we need to be cautious about comparing NAV REITs' performance with listed REITs' performance over such a short time period, because the winds can quickly change. We've got a seven-year track record, but most of the market didn't exist three years ago. And traded REITs have been a very good solution and alternative for 35 to 40 years.

Generally these are long-lived asset allocation decisions. Investors should be evaluating performance over three-year, five-year and 10-year time periods, not quarter to quarter.

So it's fair to say you don't see yourself as in competition with the listed REITs.

Not at all. As an institutional manager, we have a huge client base, and we manage listed REIT stocks. I recommend that advisers tell clients to have exposure to the private side if their priority is stability of value and good income, and to have exposure to the public side if they're looking for a little higher yield and more strategic focus. Most of our institutional clients are involved in both, and we're a big believer in both.

Can we talk about your investment strategy?

I think what we do is a nice complementary solution to the public market. Wall Street over the years has basically made publicly traded REIT CEOs sharpshooters and specialists; public REITs generally only operate in one, or maybe a couple, segments. Whereas we have the freedom to invest in any property type in any locale across the entire $16 trillion U.S. real estate market. We're able to find value in specific corners of a much larger sandbox.

Coincidentally, this is why I think NAV REITs like our product are better than the legacy nontraded REIT, which also tended to be property type-specific. They were playing for the IPO exit, and they knew Wall Street would only buy a pure-play entity.

And you get a pass on being a pure-play because you are a perpetual life product that is not targeting an exit, per se?

That's correct. We are private forever. And additionally, our firm and other institutional players now in the space have long track records, generally, investing in multiple property types across multiple cycles.

Where specifically do you see value in the near term?

Generally we're after stable, reliable sources of yield. Right now we're significantly underweight in office, because it has generated the least amount of return from cash flow; it's more of an IRR play, a capital appreciation play. You have to put a lot of money back into office properties to re-tenant them.

We've liked industrial for some time for its triple-net leases and low capital requirements, and we were big buyers back in 2012. Industrial now represents about 26% of our $3 billion portfolio.

Generally we steer away from the niche segments, because we're a core investor. But we really like medical office, in part because of its late-cycle, defensive characteristics. Even through the Great Recession, the health care sector had positive growth and increased employment. More and more Americans are requiring health care services, and health care services are increasingly being delivered in medical office settings rather than hospitals.

And for growth, we've been adding multifamily, for its short lease durations. Multifamily represents about 30% of our portfolio.

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