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ALTERNATIVE INVESTING

A Real-Estate Primer

Direct ownership offers income, but REITs might be better for some

By GREGORY ZUCKERMAN

Q: What's the best way to invest in real estate today? "Hard" real-estate investments or "soft" shares and ETFs?

A: As housing finally rebounds, investors are searching for the best ways to take advantage. Tim Courtney, chief investment officer at Exencial Wealth Advisors, says an investment portfolio of more than $10 million could benefit by including both "hard" real estate, meaning direct ownership—either full or partial—of commercial, residential or other properties, as well as "soft" real estate, such as shares of real-estate investment trusts or other securities.

Those with smaller portfolios who want to invest in real estate generally should stick with real-estate investment trusts, or REITs, exchange-traded funds, shares of real-estate-focused companies and other investments that provide more liquidity than direct property ownership, experts say.

Properly researching and monitoring hard real-estate investments generally requires a significant commitment of time, making shares more attractive for most individual investors. It also can take longer to see gains from hard real-estate investments, though these investments do have the potential to provide sizable, steady income, says Deann Morgan, a managing director with Bank of America Merrill Lynch. Matthew Tuttle, president of Tuttle Wealth Management LLC in Stamford, Conn., adds that while investment properties can be attractive investments, they can be hard to value.

For those going the soft route, Mr. Courtney notes that U.S. REITs have done well this year, and says they are no longer bargains. He says international REITs are more attractive, some offering dividends of about 5%.

"It's best to own an index fund that provides exposure to a large basket" of REITs, Mr. Courtney says, to avoid the volatility of individual shares. He's a fan of REITs funds offered by Dimensional Fund Advisors and Vanguard Group Inc.

For some investors, though, hard investments remain more attractive. "The returns on REITs and similar investment vehicles, after management expenses, aren't substantial enough to deter our clients" from investing directly in real-estate properties, says James Carolan, a partner and head of the U.S. real-estate practice at the international law firm Withers Bergman.

Jeff Leventhal, managing director and partner at financial-services firm HighTower in Bethesda, Md., is focusing on parts of the market that held up during the downturn, such as self-storage facilities, college housing and medical office facilities. Those sectors should hold up again if the economy slips into another recession, he says.

Mr. Leventhal also is targeting distressed residential markets, "but given most of our clients own their home, we prefer to look outside this space, for enhanced diversification."

One option for deep-pocketed investors: Funds focusing on real estate managed by private-equity firms, which typically offer higher returns than public REITs, says Jack Foster, head of real assets at Franklin Templeton Real Asset Advisors. But, he adds, the private funds also entail significant risk.

"Investors need to consider lockup periods that can be as long as five years," says Mr. Foster. Still, the expanded pool of distressed property owners after the recent financial crisis and economic downturn "has created significant opportunities in private-equity real estate," he says.

On the whole, "the days of flipping for a quick profit are dead," says Scott Miller Jr., a managing partner of Blue Bell Private Wealth Management LLC in Blue Bell, Pa. "But for an investor who understands their local market, is willing to do the research, is patient enough to get a great buy and has the skill set to perform the necessary and ongoing maintenance, hard real-estate investments will prove to be more profitable" than soft ones.

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