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Investors should look beyond REITs to gain real estate exposure: Jeffrey Kolitch

The portfolio manager of the Baron Real Estate fund says investors should look at cruise-line companies, cell-tower operators, casinos, and real estate infrastructure firms

By Jeff Benjamin

The real estate market, in general, still has plenty of potential for growth, but investors should start thinking beyond just real estate investment trusts to gain exposure.

"Given where we are right now in the cycle, we advocate a broader more inclusive approach to real estate investing," said Jeffrey Kolitch, portfolio manager of the $1.5 billion Baron Real Estate fund.

Speaking Monday in Orlando at the IMCA annual conference, Mr. Kolitch addressed a common investing mistake of being overly concentrated in REITs and not considering the myriad other ways to gain exposure to the asset class.

Since most financial advisers rarely allocate more than 10% of a client's portfolio to real estate, REITs are often used as a quick and easy way to get a diversified portfolio of real estate. But, according to Mr. Kolitch, the real estate market can be sliced in so many ways that even a diversified REIT portfolio might be too concentrated into a single subcategory of the asset class.

"I think REITs are fairly valued, but pricey right now," he said. "And a REIT-only approach has more possibilities of vulnerability."

While it takes a little more work to build your own diversified real estate allocation, Mr. Kolitch said the key is thinking beyond traditional residential and commercial properties.

Real estate companies, home builders and land developers usually come to mind first when considering individual real estate allocations, but Mr. Kolitch said exposure to the asset class can also be gained through cruise-line companies, cell-tower operators, casinos and companies involved in real estate infrastructure.

Despite a start to the year that Mr. Kolitch described as the "worst three weeks for real estate since the Great Depression," he maintains a "favorable outlook" for the asset class. "The ingredients that fueled the real estate recovery are still in place, including low interest rates and demand outstripping supply in many areas," he said.

While he doesn't believe a recession is imminent, Mr. Kolitch did advise investors to dial back their expectations for the kind of mid-teen compound returns that real estate has seen since 2009.

"I think the returns going forward will be more moderate," he said. "Some segments are overheated, or dealing with too much supply, but a broad downturn is unlikely."

The main reason he believes real estate will avoid a broad downturn is because of the imbedded backstop in the form of billions of dollars in cash on the sidelines from large investors like private equity giant The Blackstone Group.

"Blackstone is essentially the landlord of the economy across every category, and they're still sitting on billions, and they're able to step in and buy," he said.

Another sign of support for real estate comes from a dearth of new residential housing.

"We're building too few homes to shelter the growing population," he said. "Right now housing is growing at 1.5 million units a year, which is low relative to our needs. We need about a million more new homes, and that bodes well for housing because it means prices are going up."

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