DANA Investment Advisors

The REITs Are Coming!

In November 2014, S&P Dow Jones Indices and MSCI announced their decision to create an eleventh GICS sector, Real Estate. The new Real Estate sector will contain REITs and other listed real estate management and development companies. Mortgage REITs will remain part of the Financial Sector. Over the last 25 years, listed U.S. Equity REITs grew from $9 billion to nearly $900 billion in market cap. The decision to reclassify REITs was made in part because of their growth and feedback that Real Estate is being viewed as a distinct asset class. The changes will be effective at the close of business on August 31, 2016. Sector weights and securities will be made available in early July. Current estimates put the new REIT sector weight at approximately 2-3% for the S&P 500, 4-5% for the Russell 1000 Value, 2-3% for the Russell 1000 Growth and 7-9% for the Russell 2000.

Securities moving into the Real Estate Sector will have increased visibility and therefore will likely gain analyst coverage. Estimates of net new investment from active managers and new product creation range from $19B (Goldman Sachs) to over $100B (Cohen & Steers). Other potential scenarios are lowered volatility from a broadened investor base, a better understanding and analysis of valuations and growth of REITs, and industry consolidation.

By most indications and estimates, the Real Estate Sector will have a similar weighting to the Materials, Telecom, and Utilities sectors of the S&P 500 Index. Given our sector neutral philosophy, our Large Cap, Catholic, SRI, and All Cap strategies will likely hold one or two positions. Depending on the exact sector weight in their relative index, Growth and Value strategies will also hold one to two positions. Our 'industry awareness' already has most of our equity strategies currently exposed to REITs. Large Cap, Catholic, and SRI strategies all currently hold one Real Estate Sector position and All Cap and Value hold two. Small caps will be impacted the most because of the sector's relative weight in the Russell 2000. Our Small Cap strategy will likely hold three to five real estate related names. However, this won't be much of a change since the Strategy has maintained industry weights to REITs within the Financials Sector since 2013.

Historically, many managers had difficulties investing in REITs given that REITs are not valued like traditional companies on an earnings per share (EPS) or book value basis (BV). Rather the stocks are valued under different criteria including funds from operations (FFO), adjusted funds from operations (AFFO) and net asset values (NAV). A Bank of America research piece cited high valuations and low long-term growth rates as the primary reasons for underweighting the industry for years. Our Equity team was preemptive in their research and began separating REITs from Financials within our Quantative Model over two years ago. We are fully prepared for the sector addition and have analyzed and held REITs historically in all of our equity strategies.

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