REITs Vs Syndications: Which Is Better for Passive Investment?

Introduction

If you’re looking at jumping into real estate investment as a passive investor, there are lots of options on the table. Even without being the landlord, you can still make great returns on real estate in every sector.

One of the most highly recommended option is investing in a Real Estate Investment Trust (REIT). But, just because it’s a really common option doesn’t mean it’s the best choice for you. When you compare REITs to Real Estate Syndications, you might find that there are better returns available elsewhere. REITs are simple and convenient, but they’re not your only choice and may not even be your best choice in the long-term.

To give you an idea about how REITs and syndications are different and which one you may want to look into, let’s take a closer look at both.

For simplification, we’re going to stick to discussing multifamily syndications rather than syndications in general.

Learn more about syndications here: [What Is a Real Estate Syndication?]

Differences Between REITs & Syndications

When you buy into a REIT, you're buying stock in a fund that owns a real estate asset. REITs own many different properties within a particular asset class. Meaning, if you buy into a retail REIT, the fund will own real estate in the retail sector.

REITs are blind funds. When you buy into the fund, you don't get any say in what the fund invests in. The fund buys and sells assets without consulting investors. It's a truly passive investment, but also one over which you have very little control.

Syndications are a form of combined investment. A group of investors join together to purchase a specific property. Although they can also be done blind, most syndications are not structed this way. A business plan is laid out ahead of purchase and the asset is usually purchased through an LLC.

While both REITs and syndications buy into properties, there are distinct differences in the ownership, risks, capital requirements, and benefits.

Your Role in the Investment

Ownership is one of the biggest differences between REITs and syndications. Buying into a REIT gives you ownership into the investing entity while syndication gives you ownership into the asset itself. REITs are more closely related to stocks and bonds rather than true real estate investments. Your returns come from ownership of real estate, but you don't directly own anything except for shares in a company investing in real estate.

With a REIT, you're not able to make any decisions about where money is invested. You're simply a hands-off, passive investor without any real knowledge of what's going on with the assets in possession of the REIT beyond what they make publicly available.

With a syndication, you are directly involved in the purchase of the real estate asset. Before you buy in, you're given information about the investment property so you can perform your own due diligence on the opportunity and potential returns.

As an investor in a syndication, your role is still passive, but you'll always be involved in the impactful decisions regarding the asset. Once you buy in, there is a sponsor (syndicator) who handles everyday management of the asset. However, as an investor, you have partial ownership in the asset itself rather than owning a share of the fund only.

Risks

Ownership isn't just a matter of control. The risks involved in REIT investments are greater than those involved in syndication, especially when there's a downturn in the real estate market.

REITs are affected by the market more directly than multifamily syndications. Unlike syndications, when the market value of your REIT holdings goes down, you do not have any equity to fall back on. Syndications give you direct equity in a physical asset, allowing some cushion against total loss of value.

Because REITs are subject to the whims of the market, you also have the emotional struggle that comes with it. Your money is constantly in an instable position and could lose value overnight. This makes market downturns even more stressful for you emotionally. Syndications don't suffer the same volatility in valuation. In this case, being illiquid is actually a benefit for you because the asset is not subject to the rollercoaster ride of the market, which can go up and down based on a tweet, regardless of the facts.

Another benefit of syndication is that you're able to fully evaluate the investment property before you buy in. This gives you the chance to make a judgment call based on the actual attributes of the property. You can perform your own risk assessment to know what you're getting into. With a REIT, you have much less information about the assets owned by the fund, so you can only go on the historical success of the fund itself.

Maximizing Your Passive Investment

In terms of returns, there's a lot to compare. REITs tend to outperform the stock and bond markets, but there are definite disadvantages. First, REITs distribute income in the form of dividends, which are not tax deductible. They also distribute from net income rather than earnings, resulting in a lower payout. Lastly, there are often fees and charges associated with REITs which may not be fully transparent.

Syndications distribute income before depreciation, allowing you to significantly reduce your tax burden through claiming asset depreciation. All fees and costs associated with managing a multifamily syndication are known upfront, with investors being able to access any financial or operational documents. As long as the project sponsor (who is also an investor) is managing the property well, investors can expect a fairly stable return.

Capital Requirements

Syndication can be trickier to navigate than REITs. Whereas REITs are publicly traded entities that anyone can buy into with any amount of capital, syndications are more exclusive. Only recently have syndications been allowed to advertise publicly, and even then, they are generally limited to accredited investors; a limited amount of sophisticated investors can participate in non-advertised syndications.

As previously mentioned, REITs have a higher liquidity than syndications. You can buy in within minutes and sell your shares again almost instantly. With a syndication, your buy-in amount is larger, the time taken in due diligence and buying in is longer, and selling is not a quick process.

When you buy into a syndication, you need to be prepared to hold the asset for the length of the investment period. Most multifamily syndications hold the asset for at least 5-7 years, with cash flowing to investors throughout the hold and at the time of sale.

You can't buy into a syndication with $100 USD. If you're only looking for somewhere to put a very small amount of capital, REITs are better for small investments. You need more capital to invest in a syndication. The exact amount you put in depends on the specific multifamily project the syndication is taking on. Most of the projects I invest in require around $50,000 capital.

Final Thoughts

Both REITs and syndications have merit as real estate investments. However, multifamily syndications tend to provide more value for money, giving you a higher rate of return at the end of your investment period and stronger, more consistent cash flow.

REITs are a great tool to help you diversify your portfolio and dip your feet into real estate investing. But, if you’re looking for better returns and a more secure long-term asset, multifamily syndications outperform REITs nine times out of ten.