REAL ESTATE INVESTMENT TRUSTS (REITS)

REIT Structure: The **REIT** structure was created by the US Congress in 1960 to allow small **Investors** to participate in the **Property Markets** without paying a **Corporate Tax**. **REITs** provide **Liquidity, Dividends**, **Diversification**, and **Professional Management**. If all **REIT Rules** are met, a **REIT** will not pay **Tax** at the **Entity** level, **REIT Dividends** will be **Taxed** to the **REIT's Shareholders**, but **REIT losses** will not be passed through to the **Shareholders**.

Types of REITs: Most **REITs** are **Equity REITs** that primarily own **Properties**, and the rest are **Mortgage REITs** that primarily own **Mortgage Debt** and **MBS**. Most **Equity REITs** focus on a single **Property** type (**Office**, **Retail**, **Apartments**, **Industrial**, **Hotels**, **Self-Storage**, etc.). **Mortgage REITs** focus on either **Residential Mortgages** or **Commercial Mortgages**.

REIT Qualifications: **REITs** must be managed by a **Board of Directors**; must have at least **100 Shareholders**; not more than 50% of a **REIT's** shares can be held by five or fewer **Shareholders** (“**5/50” Rule**); **Shares** must be **Fully Transferrable**; can be **Public** or **Private**.

Distribution Requirements: At least **90%** of a **REIT's Taxable Income** must be distributed as **Dividends** to the **REIT's Shareholders**, otherwise the **REIT** will pay **Corporate Tax**.

Asset Requirements: At least **75%** of a **REIT's Assets** must be related to **Real Estate**, government securities or cash, and not more than **20%** of a **REIT's Assets** can be in **Taxable REIT Subsidiaries** (TRSs were authorized by the **1999 REIT Modernization Act**).

Income Requirements: At least **95%** of a **REITs Gross Income** must be from **Real Estate Rents**, **Profits** from **Asset Sales**, **Mortgage Interest** income and **REIT Dividends** received.

Net Asset Value (NAV): **Net Asset Value** is an accounting measure of a **REIT's Net Worth**, which may or may not accurately reflect its current **Market Value** if the **REIT's Assets** have increased or decreased in value relative to their **Depreciated Cost**. If a **REIT's Stock Price** reflects its **NAV** more than its true **Market Value**, the **REIT** may be a takeover candidate.

Funds from Operations (FFO): **REIT Income** is measured as “**Funds from Operations**”, which is **Earnings per Share** (**EPS**) adjusted by adding back **Depreciation** and excluding any **Profits** or **Losses** from **Asset Sales**, and is a measure of its **Dividend** paying ability.

UPREITs: **Umbrella Partnership REITs** issue **Operating Partnership Units** (**OP Units**) that are **Convertible** into **REIT Shares** and allow a **REIT** to buy **Appreciated Properties** with **OP Units** instead of cash so **Sellers** of the **Properties** can achieve a **Section 1031** tax deferred exchange. When **OP Units** are converted into **REIT Shares**, **Capital Gain Taxes** will be due.

REIT Growth Drivers: **REITs** can 1) Increase the **Net Operating Income** from their existing **Properties** by increasing **Rents** and **Occupancy Levels**; 2) **Acquire** additional **Properties**; 3) **Renovate** or **Expand** existing **Properties** or **Develop** new **Properties** on excess **Land**; 4) Provide **Property Services** through **Taxable REIT Subsidiaries** (**Leasing** or **Property Management**); 5) **Financial Engineering** (**Property Debt** or **REIT Corporate Leverage**).