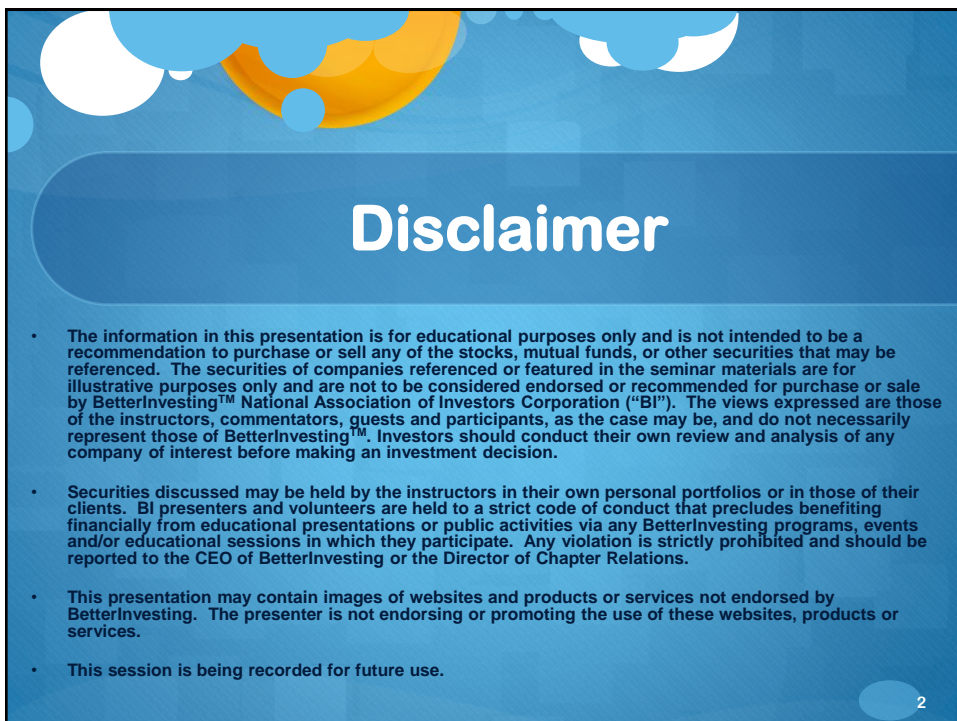
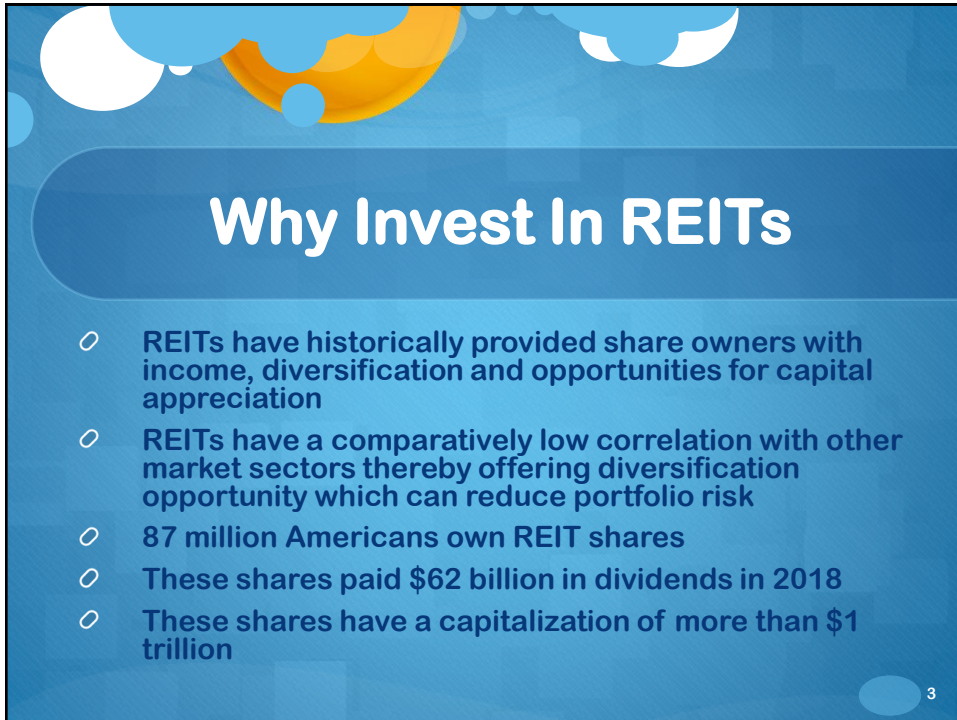




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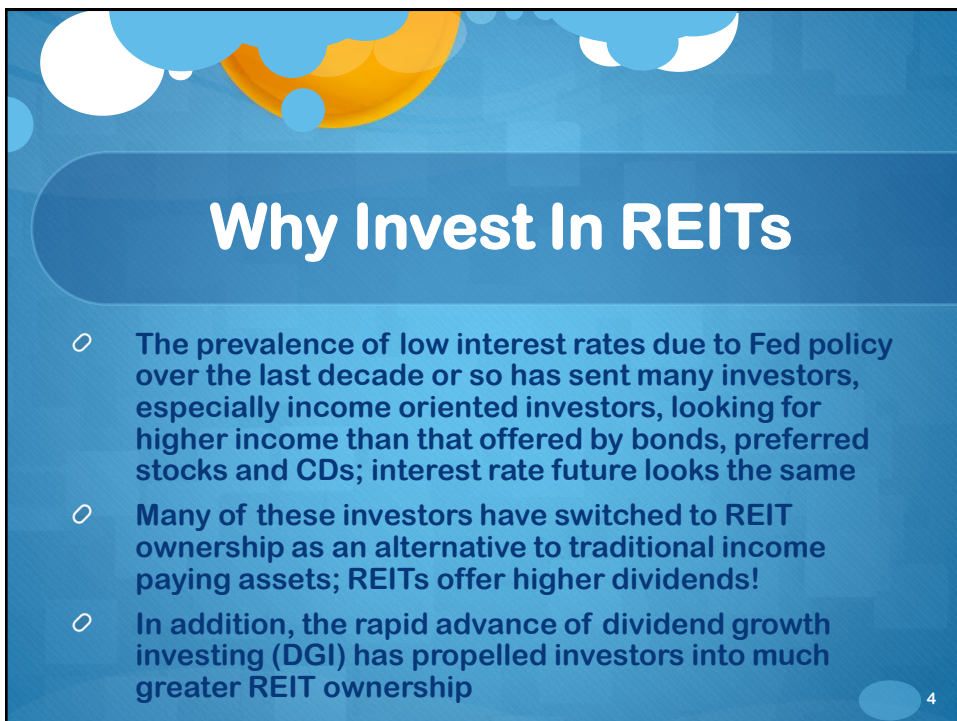


Why Invest In REITs

- REITs have historically provided share owners with income, diversification and opportunities for capital appreciation
- REITs have a comparatively low correlation with other market sectors thereby offering diversification opportunity which can reduce portfolio risk
- 87 million Americans own REIT shares
- These shares paid \$62 billion in dividends in 2018
- These shares have a capitalization of more than \$1 trillion

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Why Invest In REITs

- The prevalence of low interest rates due to Fed policy over the last decade or so has sent many investors, especially income oriented investors, looking for higher income than that offered by bonds, preferred stocks and CDs; interest rate future looks the same
- Many of these investors have switched to REIT ownership as an alternative to traditional income paying assets; REITs offer higher dividends!
- In addition, the rapid advance of dividend growth investing (DGI) has propelled investors into much greater REIT ownership

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Investing In REITs

- There are many publically traded individual REITs that can be bought through your broker, just like any other publically traded stock
- Some investors buy individual shares of REITs that are in favor per a recommended list, based on what their favorite REIT analyst suggests or based on their own research
- In addition to owning individual stocks, there are specialized ETF and traditional mutual funds available that only own REITs

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What Is A REIT?

- A real estate investment trust (“REIT”) is a company that owns, operates or finances income-producing real estate. REITs provide all investors the chance to own valuable real estate, present the opportunity to access dividend-based income and total returns, and help communities grow, thrive, and revitalize.

- WWW.REIT.COM

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What Is A REIT?

- REIT is an acronym for Real Estate Investment Trust
- REITs were created under federal law, the Real Estate Investment Trust Act of 1960; first REIT created in 1963
- This legislation was intended to give investors opportunities to invest in real estate based activity on a tax advantaged basis without having to directly own the real estate
- REIT investing was thereby made more liquid for investors rather than requiring investors to deal directly with and own the real estate itself
- REITs can be traded on a 1) public exchange, 2) traded publically although not on an exchange or 3) traded privately

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How Is A REIT Formed?

- Under the REIT Act of 1960, any entity that qualifies for federal tax treatment may elect REIT treatment
- Any entity formed as a trust, partnership, LLC or corporation can elect to be treated as a REIT
- Publicly traded REITs are typically corporations or business trusts
- Most of these entities are trusts or corporations formed under Maryland law
- Maryland has a specific statute for trusts and has developed expertise in applying laws governing REITs

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How Is A REIT Formed?

- In order to qualify as a REIT, an entity must
 - Be beneficially owned by 100 or more persons
 - Not be “closely held” (5/50 Test)
 - Must distribute at least 90% of its earnings to shareholders
- How REITs are structured
 - Property owned by different ways; as an UPREIT, DownREIT, Stapled REIT, or Paper Clip REIT
 - With finite life or in perpetuity
 - With internal or external management

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Characteristics Of A REIT

- Most REITs trade on major stock exchanges and offer shares to the public
- REITs are similar to mutual funds
- REITs need to derive at least 75% of their income from real estate; e.g. – rent, proceeds from sale of real estate assets, mortgage loans
- At least 75% of REITs assets must be real estate assets
- At least 95% of REIT’s income must be passive

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Characteristics Of A REIT

- What type of assets do REITs typically own or control?
 - Properties included in a REIT portfolio may include shopping malls, apartment complexes, data centers, health care facilities, hotels, infrastructure—in the form of fiber cables, cell towers, and energy pipelines—office buildings, retail centers, self-storage units, timberland, and warehouses
 - Most REITs focus on specific types of real estate properties, but some REITs are hybrids and hold a mix of assets

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Characteristics Of A REIT

- How do REITs grow?
 - Regular corporations usually retain their earnings and cash flow or a portion thereof in order to fund growth by internal means, also use debt
 - However, since REITs are required to distribute at least 90% of their earnings, they grow by issuing debt and/or selling more shares
 - While selling shares can dilute current shareholders, the better managed REITs have been able to overcome this disadvantage over time through astute management

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Types Of REITs

- Equity REITs – are entities which own or operate income-producing assets (focus of this presentation)
- Mortgage REITs – mREITs provide financing for income-producing real estate by purchasing or originating mortgages and mortgage backed securities, earning income from the interest on these investments
- Public Non-Listed REITs – PNLRs are registered with the SEC, but do not trade on national stock exchanges
- Private REITs – Private REITs are offerings that are exempt from SEC registration and whose shares do not trade on national stock exchanges

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Important REIT Metrics

- Triple Net Lease – is a rental arrangement relied on by many Equity REITs; how does this work?
 - Tenant agrees to pay (1) property taxes, (2) insurance and (3) maintenance in addition to rent and utilities
 - Single and double net leases are also popular
 - All forms of net leases lower risk to REIT, but risk ultimately depends on the creditworthiness of the tenant

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Important REIT Metrics

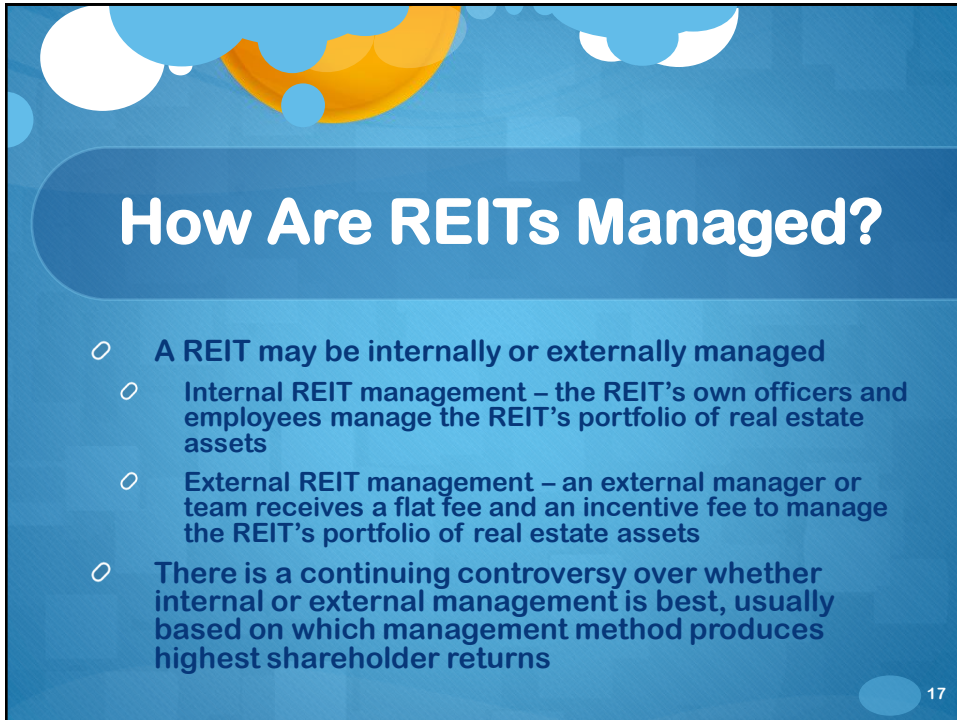
- **Funds From Operations (FFO)**
 - FFO is a standardized term: $\text{GAAP Net Income} + \text{Depreciation} + \text{Amortization} - \text{Gains from Property Sales}$
 - Since much real estate grows in value over time, FFO is better for determining how safe dividends are
- **Adjusted Funds From Operations (AFFO)**
 - This metric seeks to measure a REIT's ongoing Funds From Operations (FFO) after deducting funding for capital expenditures
 - Although widely used, there is no standardized definition of AFFO so investors need to understand how a REIT or data provider defines their AFFO metric

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Important REIT Metrics

- **Payout Ratio – Yield for a REIT**
 - $\text{Dividend} / \text{FFO}$ or $\text{Dividend} / \text{AFFO}$
 - Don't use $\text{Dividend} / \text{EPS}$ since REIT's reported earnings are substantially lowered by non-cash depreciation and amortization expenses; FFO or AFFO used in place of EPS
- **Debt / EBITDA**
 - This metric is a leverage measurement used by credit agencies to determine how risky a REIT's debt is
 - Low credit ratings increase a REIT's cost of borrowing, potentially reducing its performance and future growth

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How Are REITs Managed?

- A REIT may be internally or externally managed
- Internal REIT management – the REIT’s own officers and employees manage the REIT’s portfolio of real estate assets
- External REIT management – an external manager or team receives a flat fee and an incentive fee to manage the REIT’s portfolio of real estate assets
- There is a continuing controversy over whether internal or external management is best, usually based on which management method produces highest shareholder returns

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REITs Are Neat

Questions?

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Taxation Of REIT Dividends

- Tax issues are common in the investing world
- This is definitely true for REITs, but not more so than for other types of investments
- The following slides on REIT taxation are only meant to outline and illustrate the tax treatment of REITs and their distributions, but complexities and problems remain
- **THEREFORE, YOU SHOULD CONSULT A TAX PROFESSIONAL FOR GUIDANCE IN ALL SITUATIONS INVOLVING REIT INVESTMENTS**

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REIT Taxation

- REITs have many of the same valuation and accounting rules applied to them as are applied to corporations and other entities
- As long as a REIT distributes at least 90% of its income to shareholders, there is no tax to the REIT on such income distributions, except for retained earnings
- There are three types of REIT distributions: ordinary dividend, capital gains, untaxed reduction of basis
- Originally, REIT dividends were taxed at ordinary rates; they did not receive beneficial treatment as “qualified dividends”

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Taxation Of REIT Dividends

- The 2017 Tax Cuts & Jobs Act reduced the tax on pass-through income by 20% up to the end of 2025
- The dividend payments made by REITs, as pass-thru income, are taxed to shareholders as ordinary income at the shareholder's marginal tax rate with the benefit of the 2017 TCJA reduction
- Portions of REIT distributions identified as “return of capital” are not taxed at distribution, but lower the shareholder’s cost basis, and thereby increase the shareholder’s capital gains tax when their REIT shares are sold

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Taxation Of REIT Dividends In IRAs & 401Ks

- Tax treatment of REIT dividends received in a sheltered account depends on the type of account that holds the REIT
- When REIT dividends are paid into a Roth IRA, there is no tax on such dividends when received or when withdrawn (free income benefit)
- When REIT dividends are paid into a Conventional IRA, such dividends are not taxed when received, but are taxed on withdrawal; the 20% reduction is lost
- When REIT dividends are paid into a 401K, such dividends are not taxed when received, but they are taxed on withdrawal; the 20% reduction is lost

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Analyzing REITs

- REITs are dividend paying stocks that own or control real estate
- REITs are generally analyzed like other stocks, but there are some differences due to the way real estate property is treated for accounting purposes and because 90% of REIT earnings are distributed
- This means that we can't use the standard SSG process and its accompanying company data to analyze REITs, but there is a way around this problem for motivated investors

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Analyzing REITs

- As mentioned, REITs have three possible income categories on a 1099; dividends, capital gains and reduction of basis
- Often, adjustments to or recharacterization of distributions are made late in reporting period
- Late receipt of final numbers is stressful and may also result in need to file an amended tax return

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Analyzing REITs

- REIT ownership adds more work and stress for club treasurers so my recommendation is to avoid REITs in investment clubs, however individuals should consider REITs for their portfolios
- Note that dividends are not taxed in a ROTH IRA when received or withdrawn so investing in REITs, which often come with higher than average dividend payouts, is well worth an investor's consideration
- **The Taxman Cometh: REIT Tax Myths by Hoya Capital Real Estate; Seeking Alpha, 2/10/2020**

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Analyzing REIT Via SSG

- Let's assume you want to analyze a REIT for your own portfolio; how would you go about doing this?
- Create an SSG using FFO or AFFO data in place of earnings; FFO data is usually easier to find
- While REITs are included in the universe of stocks for which online SSGs can be created, these REITs don't come with FFO or AFFO data so a reliable SSG isn't possible
- Consider using the FFO or AFFO work-around

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Analyzing REIT Via SSG

- Ann Cuneaz, Senior Manager of Education at BetterInvesting did an excellent StockUp study of Realty Income (NYSE: O)
- Realty Income is an equity REIT definitely worthy of consideration
- This April 12, 2018 study, included an SSG using FFO data which was substituted for original EPS data; very helpful supporting explanations
- Expanding investment emphasis on REITs makes it possible that FFO and/or AFFO data will be included for online SSG use in the future

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Analyzing REITs

- Where can you find the necessary FFO or AFFO data to use for your REIT SSG?
 - Company website, financial statements including the annual report
 - CFRA Stock Reports, offered by some brokers
 - Value Line has FFO, but not AFFO
 - Morningstar, has financial reports, but no historical FFO or AFFO information
 - REIT- centric websites have FFO and AFFO information available along with analysis and performance data

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Creating A REIT SSG

- Start an online SSG report for a REIT using its stock symbol, e.g. – VTR
- Rename the SSG in Company Data to reflect that FFO or AFFO data is being used; e.g. – Ventas (FFO Data)
- Replace all the annual data year for year with annual FFO or AFFO data
- Replace the quarterly data in a similar fashion; 5 quarters at a minimum has been suggested
- Enter your usual SSG projections
- Analyze and save the completed REIT SSG report

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Caution Re REIT SSG

- In Section 5 of SSG, the default value of the % Payout is based on the original EPS derived data
- Payout now for O shows 216%, more realistic and usable FFO payment is around 83%
- Unfortunately, changing the EPS annual data to FFO or AFFO annual data does NOT change % Payout value; per Ann Cuneaz's StockUp study
- Therefore, you need to separately calculate the correct % Payout that is based on an average % Payout of the FFO or AFFO data

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Summary

- Don't be reluctant to invest in REITs, especially in a Roth IRA
- Don't lower your quality standards to chase REIT yields; it's dangerous, don't do it!
- Keep a watchful eye on valuations, when you buy and when valuations prompt you to sell
- Focus on REITs with sustained dividend growth rates and reasonable prospects for continuing such growth
- Make sure the payout ratio won't get the REIT in financial difficulty

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Summary

- Diversify across multiple sectors (types of REITs) when possible; this is easier to do if you invest in funds, but that's not always a satisfactory tradeoff
- Be aware of and coordinate share purchases and sales around ex-dividend and record dates
- Keep a log showing when REIT dividends will be paid; you should already know their quarterly payment cycle
- Remember that not all dividend paying REITs are potential buys for that reason alone; do your due diligence!
- Be ruthless in applying your sell criteria

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- Investing In REITs, by Ralph L. Block, Blumberg Press, 2011, 4th Edition
- The Intelligent REIT Investor, by Stephanie Krewson-Kelly & R. Brad Thomas, Wiley Publishing, 2016
- Complete Guide To Investing In REITS, by Mark Gorden, Atlantic Publishing, 2008

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- NAREIT Magazine & Newsletters, several available, subscription, go to www.reit.com
- Forbes Real Estate Investor, R. Brad Thomas, subscription
- REITs, Kiplinger, general material

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References - Websites

- NAREIT website @ www.reit.com,
- R. Brad Thomas and other REIT analysts, @ seekingalpha.com, look in Income Digest
- How To Analyze Real Estate Investment Trusts, <https://www.investopedia.com/articles/04/030304.asp>

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Source Of REIT Information

- NAREIT is often referenced by various books, newsletters, articles and websites; what is NAREIT?
- “Nareit is the worldwide representative voice for real estate investment trusts—REITs—and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community.”
- Some of the information and data in this presentation is sourced from NAREIT

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Questions?

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