ESTATE INVESTMENT TRUSTS

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How To Invest In

REAL ESTATE INVESTMENT TRUSTS

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What Is a REIT?

A real estate investment trust (REIT) is a company that manages and operates primarily in real estate assets. REITs are securities that trade on exchanges like stocks, but have specific requirements for maintaining REIT status.

The majority of REITs operate their businesses by owning properties and renting units out to tenants, but some REITs focus on financing properties and mortgages.

The History of REITs

The United States Congress created REITs in 1960 to allow average investors to invest in real estate. Since then, the number of REITs has grown tremendously. As of January 2012, there were 166 publicly-traded REITs registered with the Securities and Exchange Commission. This number has grown 16% since 1991, while market capitalization of all U.S. REITs has increased 3,374%.

In 1965, Continental Mortgage Investors became the first REIT to be listed on the New York Stock Exchange. Four years later, in 1969, the first European REIT legislation was passed, marking the beginning of a global REIT industry.

REITs Are Everywhere

Although there are many people who have not heard of REITs, these companies are located all around us. REITs invest in real estate assets such as apartment buildings, student housing buildings, shopping centers, medical facilities, hotels, office buildings, cell towers and mortgage assets.

REITs trade on exchanges like stocks and can be purchased through a broker. Similar to stocks, investors can purchase common stock, preferred stock or debt securities of REITs.

REIT Qualifications

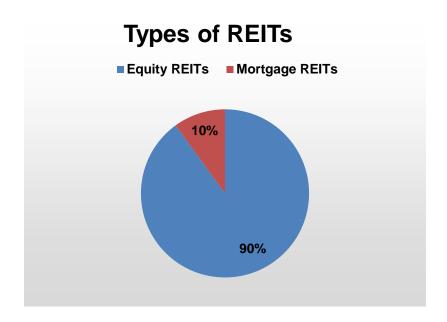
For a company to qualify as a REIT, 75% of its assets must be in the form of real estate. A REIT must also distribute at least 90% of its taxable income to shareholders in the form of dividends.

The Securities and Exchange Commission (SEC) requires several other factors to determine if a company qualifies for REIT status. To be considered a REIT, a company must:

- Be managed by a board of directors or trustees.
- Have 100 or more shareholders after holding REIT status for a year.
- Obtain at least 90% of its gross income from real estate sources.
- Have shares that are transferable.
- Have no more than 50% of its shares owned by five or less investors during the second half of the taxable year.

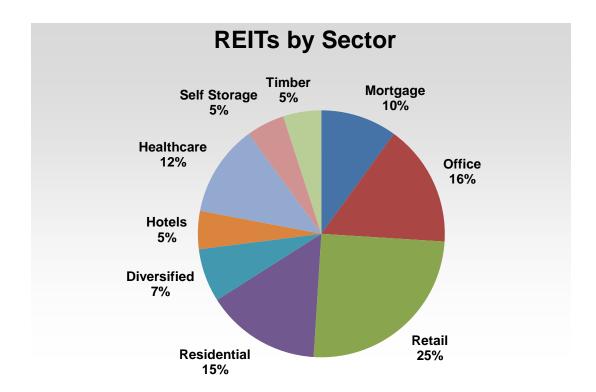
Types of REITs

There are three main types of REITs: **Equity**, **Mortgage** and **Hybrid** REITs. Equity REITs account for 90% of REITs, while mortgage REITs make up the remaining 10%. Hybrid REITs are a combination of both equity and mortgage REITs.



Equity REITs focus on property management and increase income by making acquisitions and managing properties. For these REITs, the primary source of revenue comes from rents. **Boston Properties** (BXP) and **Vornado Realty Trust** (VNO) are two major equity REITs.

Depending on the specific company, an equity REIT may focus on obtaining certain types of real estate assets such as apartment buildings, office buildings or hotels. Other companies may focus on managing properties in specific geographic areas.



Equity REITs are usually categorized into the specific types of properties they invest in. Below are the most common types of equity REITs:

Retail REITs

Retail REITs invest in retail outlets such as shopping malls and shopping centers. This type of REIT accounts for 24% of REIT investments. Retail REITs obtain income by collecting rent from tenants.

Key Investment Concept

While considering an investment in a retail REIT, it is important to analyze the specific retail industries that the company invests in, since these REITs depend on tenants to pay rent to maintain a steady cash flow.

Simon Property Group (SPG) is one of the most well known REITs in the retail sector. SPG's properties primarily consist of shopping malls and outlet centers. The company was founded in 1960 and is headquartered in Indianapolis, Indiana. Click here to view current dividend data for SPG.

Healthcare REITs

The performance of healthcare REITs is directly related to the current state of the healthcare system. These REITs invest in healthcare-related real estate such as hospitals, medical centers, nursing facilities and retirement homes.

Healthcare REITs depend on occupancy fees, Medicare and Medicaid reimbursements, and the payment of private bills to earn revenue. Health Care REIT (HCN) is a healthcare focused REIT that specializes in senior housing and nursing homes. In addition to senior healthcare properties, the company also has a range of other medical facilities included in its \$20 billion portfolio. The company was founded in 1970 and it's based in Toledo, Ohio. Click here to view current dividend date for HCN.

Office REITs

Office REITs invest in office buildings and usually have tenants with long-term leases. Essential factors to consider when investing in an office REIT are: the current unemployment rate, number of vacancies in office buildings and the local economy of the buildings' locations.

that focuses on the ownership and development of office buildings in Boston, New York, Washington DC, San Francisco and Princeton, NJ. The REIT is one of the largest office REITs, and markets to high quality tenants. The company was founded in 1970 and is headquartered in Boston, MA. Click here to view current dividend data for BXP.

Residential REITs

Residential REITs invest in apartment buildings and rely on tenant rent for revenue. Most of the larger residential REITs operate properties in high cost areas like Los Angeles or New York where they can charge higher rents.

Avalon Bay Communities (AVB)

focuses on acquiring and operating apartment complexes in high barrier to entry markets. The company has real estate assets in 10 states and the District of Colombia. AVB was founded in 1978 and is based in Arlington, Virginia. Click here to view current dividend data for AVB.

Mortgage & Hybrid REITs

Unlike equity REITs, **Mortgage REITs** operate their business by investing in real estate loans. These companies operate as finance companies for real estate property owners. Two examples of mortgage REITs are American Capital Agency Corp. (AGNC) and Annaly Capital Management (NLY).

There are currently about 40 mortgage REITs. Around 25 of these companies invest in residential mortgage, while the remainder invests in commercial mortgages. Mortgage REITs can be good investments when interest rates are low, because they are able to borrow money at low rates which they then invest in higher-yielding mortgage assets.

Hybrid REITs have qualities of both equity and mortgage REITs. These REITs make mortgage loans and own properties. Hybrid REITs earn income from both rent and interest fees. American Capital Mortgage Investment (MTGE) and Apollo Residential Mortgage (AMTG) are both examples of hybrid REITs.

Investing in REITs

Many investors are now adding REITs to their portfolios due to their many attractive advantages. However, there are a few things every potential REIT investor needs to know before investing.

REITs Have Above-Average Yields

Investors are usually drawn into REITS due to their high yields. Since these companies are required to return at least 90% of income to shareholders in the form of dividends, the average REIT pays an 8% annual dividend yield for a 15-year investment.

Diversification & Stability

REITs can also provide investors' portfolios with diversification as they often react to market conditions differently than stocks. Since REITs have little correlation with the S&P 500, risks to an investor's portfolio are lowered by owning a REIT.

Real Estate Exposure

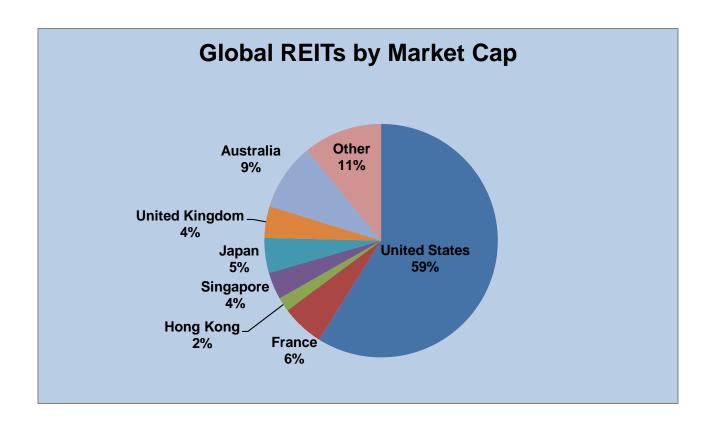
These investments make it possible for average investors to invest in real estate, while still having the advantage of a liquid asset. Since REITs are bought and sold through an exchange, the cost and convenience of owning these companies is much more manageable than investing in physical property.

Although REITs can be great investments, it is important for investors to look into the company's tax policies on dividends. Since these companies are able to deduct dividend paid from their income tax, tax obligations are often passed on to shareholders. Approximately two thirds of all dividends paid by REITs do not qualify for the 15% capital gains tax rate. Dividends paid by REITs can be taxed at an individual regular income tax rate, but cannot exceed 35%.

Investors must also realize that REITs are directly tied in with the current state of the real estate market, and thus can be volatile. Dividend yields are statistically high with REITs, but can be cut dramatically if a company is not doing well.

Global REITs

Since the first global REIT legislation was passed in 1969, 35 countries have established a type of REIT policy. Although the REIT market has expanded globally, the number of established REITs in the U.S. is much higher than any other country. U.S. REITs account for 59.3% of all REITs when measured by market capitalization. Behind the U.S., the countries with the largest amount of REIT market capitalization are Australia, France and the United Kingdom.



Although there have been 35 countries to establish a type of REIT policy, many countries have no REITs that are publicly traded on an exchange.

REIT Policies by Country

Australia

Australia established a REIT policy in 1985 and now has 45 publicly listed REITs, accounting for 9.36% of global REITs. REITs in Australia outperformed in 2012 compared to REITs in the U.S., Singapore and become a REIT in Australia, it is required to limit its operations to

These REITs have no income tax obligations. Both Australian and foreign shareholders must pay a 46.56% income tax rate on capital gains

Europe. For a company to

real estate activities such as

leasing.

France

In 2003, France became the first European nation to establish a REIT policy. With 40 REITs total, French REITs account for 5.9% of global REITs. The policy, "Sociétés d'Investissements Immobiliers Cotées," or SIIC requires companies of REIT status to limit their business activities to property acquisition and construction with the intention to use these properties as rental properties.

The company then is exempt from income taxes. The tax rate for individual investors varies from a 60% rate, an individual's personal tax rate or a tax rate of 19% (plus 12.3% of social contributions). Taxation for individuals outside of France but still within the EU is 19%. Individuals outside of the EU are subject to a 25% tax rate.

United Kingdom

The UK has 21 REITs, accounting for 4% of the global REIT market capitalization. A UK REIT structure was established as part of the Finance Act of 2006 and was finalized in 2007.

UK REITs are required to obtain 75% of their income from property rental activities. These REITs are prohibited from investing outside of the UK. Companies are required to distribute at least 90% of their income to shareholders.

For shareholders in the UK. dividends paid are taxed at a 20% tax rate, while capital gains are taxed between 18% and 28%. Foreign investors are taxed at

What to Look for When Investing in a REIT

Funds from Operations

REITs typically report quarterly results in the form of Funds from Operations (FFO) rather than earnings per share (EPS). Since REITs are not generally measured by EPS, investors can disregard payout ratios when evaluating these companies. Instead, when looking at a REIT, focus on whether or not the company has shown steady FFO growth over the past several years.

Dividend Growth

Dividend investors should seek REIT investments with attractive and sustainable dividend vields. Even though REITs are typically high-yield investments, dividends can of course be cut at any time. The <u>Dividend.com DARS rating system</u> can help you find the best REITs to invest in.

Geographic Diversification

Investors must also take into account the company's geographic diversification of its properties. REITs that have properties spread out among many different areas are less likely to be significantly affected by factors such as local economic weaknesses or natural disasters.

Strong Management Team

Like all companies, it is crucial that upper management remains strong. To ensure the success of a REIT, management must be quick to reinvest cash into additional assets and be able to stay within the company's budget.

REITs and Dividend Reinvestment Programs (DRIPs)

Since REITs tend to have high yields, many investors enroll their REITs into dividend reinvestment programs, or DRIPs. These programs can save investors commission fees while allowing them to reinvest into the company.

Large REITs often have their own DRIP that investors can enroll in. For example, Simon Property Group (SPG) and Boston Properties (BXP) both offer company-run DRIPs that are free of charge.

For companies that do not have their own DRIP, investors may also have the choice of enrolling in a DRIP through their broker. Commission fees vary by broker, so be sure to do your research when trying to decide upon the best course of action.

Conclusion

REITs can be a great addition to a portfolio, but it is important for investors to research individual REITs as well as their tax requirements before investing. The high yields that REITs offer can be a great source of income for dividend investors, but can also be risky. Click here for a full list of dividend paying REITs.

Before investing in REITs, it may be helpful to consult a tax expert since many REITs are not subject to the regular capital gains tax rate.

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