EXPERIENCED AND INDEPENDENT ADVISORS WORKING PRIMARILY
WITH ACCREDITED ENGINEERS, EXECUTIVES, AND ENTREPRENEURS

SARVER VROOMAN
WEALTH ADVISORS

9237 Ward Parkway, Suite 320 | Kansas City, MO 64114

Real Estate Investment Trusts "REITs"

Peter Vrooman, CFA®, CIMA®, CRPC®, CAIA®
Partner, Wealth Advisor
Fundamental Choice Portfolio Manager
816-601-1152
peter.vrooman@svwealthadvisors.com

Jonathan Sarver, CPWA®
Partner, Wealth Advisor
Fundamental Choice Portfolio Manager
816-601-1151
jonathan.sarver@svwealthadvisors.com

Definition of REITs

A Real Estate Investment Trust, also known as a REIT, is a company that owns and operates income-producing real estate properties. These companies may own properties such as hotels, medical facilities, apartment complexes, office buildings, warehouses and more infrastructure. To qualify as a REIT company, there are several qualifications that a company must meet. Three principle qualifications that are worth noting are the company must invest at least 75% of its total assets in real estate, pay at least 90% of its taxable income in the form of shareholder dividends each year, and have more than 100 shareholders (Nareit April 2021)[1]. REITs allow affluent investors to diversify their portfolio with income-generating real estate properties.

Types of REITs

The three major types of REITs include:

1. Public REITs
2. Public Non-listed REITs
3. Private REITs

Outlining the characteristics of the three major types of REITs will help investors understand the key differences among them. *Public REITs* are equity REITs that operate income-producing real estate (Nareit April 2021)[1]. *Public Non-listed REITs* are registered with the SEC but do not trade on national stock exchanges (Nareit April 2021)[1]. *Private REITs* are not subject to SEC regulations and do not trade on national stock exchanges (Nareit April 2021)[1]. A key difference with private REITs is a larger minimum investment is required to invest. Private REITs are typically for accredited (U.S. SEC April 2021)[2] and affluent investors. Public REITs are the most common, and the most liquid, type of REIT in the United States.

The potential benefits of public REITs are high liquidity, tax advantages, and diversification. Public REITs are traded on major exchange platforms, which gives them liquidity just like any other stock that is traded. Another potential benefit of public REITs is they have a tax advantage. Unlike other companies traded on a major exchange, public REITs are not subject to taxation at the corporate level; public REITs do not suffer from double taxation. Public REITs may also offer diversification benefits. In general, real estate provides diversification for a portfolio, as it has a relatively low correlation to other major asset classes. More specifically, the correlation of public and private REITs can be compared to the S&P500 and the Barclays US Aggregate Bond Index to better understand the potential diversification benefits of REITs. Over the past 20 years, private REITs have had a 0.11 correlation to the equities in the S&P500 and a -0.17 correlation to bonds in the Barclays US Aggregate Bond Index; public REITs have had a 0.69 correlation to equities in the S&P500 and a 0.04 correlation to bonds in the Barclays US Aggregate Bond Index (Black Creek Group June 2020)[3]. A negative correlation indicates as one variable increases, the other decreases. A positive correlation indicates as one variable increases or decreases, the other variable moves in the same direction.

The potential benefits of private REITs are high dividend yields, no daily market fluctuations, and minimal regulatory requirements. Private REITs typically pay higher dividends than their public counterpart. More specifically, private REITs historically yield 7%-8% compared to the public REITs' yield of 5%-6% (Frankel, M. August 14, 2019)[4]. The share price of private REITs are calculated every quarter, so there are no daily fluctuations that cause panic for an investor. A private REIT is designed to be a hands-off investment. Private REITs also are subject to few regulatory requirements, which can save time and money. And, it is worth noting that private REITs may also provide diversification benefits in the same way public REITs do.

Performance of REITs

REITs have the potential to provide investors with competitive returns. As of March 2021, the FTSE Nareit All Equity REITs Index has a dividend yield of 3.8%, which is more than double that of the S&P500 1.5% (Nareit March 2021)[5]. The FTSE Nareit All Equity REITs Index has also outperformed the S&P500 in 15 out of the last 25 years (Nareit March 2021) 4. As previously mentioned, REITs offer a dividend yield ranging from 5%-8%. Nationally, the total market capitalization of all publicly traded REITs is $1.1 trillion (Frankel, M. August 12, 2020)[6]. The total market capitalization is composed of large cap, mid cap, and small cap companies. The investor can select the type of REIT to invest in based on industry and market cap. Regarding standard deviation, the 20-year annualized standard deviation of private REITs is 6.47% and of public REITs is 21.13% (Black Creek Group June 2020)3. The S&P500's 20 year annualized standard deviation is 16.89% (Black Creek Group June 2020)[3]. Lower standard deviation correlates to lower risk, thus private REITs offer a less risky investment when compared to public REITs and equities in the S&P500. Evidently, REITs can offer a steady and secure form of dividend income and long-term appreciation.

Why Should Investors Consider Adding REITs to Their Portfolio?

Often investors seek to diversify their portfolio by adding income-generating investments. Private and public REITs may provide investors with portfolio diversification, tax benefits, and dividend income. REITs are real estate assets, and as a result they are hard assets that can diversify an investor's portfolio. Whether it is geographic diversification or property type diversification, REITs enable investors to invest in different types of real estate in a variety of locations. Public REITs may also offer tax benefits because these corporations are not subject to taxation at the corporate level, meaning less is taken away by the government and more goes to the investor. REITs have also demonstrated strong historical performance and can generate steady dividend income.

Investors can buy REITs that are correlated with the growth of an industry, sector, location, or demographic trend. REITs are diversified real estate investments that are designed to be less correlated to major exchanges compared with traditional stocks and bonds. Investing in REITs with different economic sensitivity can help to further diversify the risk of a portfolio. REITs can offer investors diversification benefits and steady dividend income.

---

[1] Nariet. (2021). "What's a REIT (Real Estate Investment Trust)?" Retrieved July 6, 2021 from https://www.reit.com/what-reit.

[2] An accredited investor must have earned income over $200,000 (or $300,000 together with a spouse) in each of the past two years, or have a net worth of over $1 million (either alone or with a spouse). U.S. Securities and Exchange Commission. (2021). "Accredited Investors – Updated Investor Bulletin". Retrieved July 15, 2021 from https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3.

[3] Black Creek Group. (2020). "Private Real Estate Has the Potential to Help Investors Weather a Bear Market." Retrieved July 15, 2021 from https://blackcreekcapitalmarkets.com/wp-content/uploads/sites/2/2020/10/TL_MI_Client_Volatility_PRE-Investor-Bear-Market_0920_Final_Secure-1.pdf.

[4] Frankel, M. (2019). Millionacres. "A Beginner's Guide to Private REITs." Retrieved July 6, 2021 from https://www.millionacres.com/real-estate-investing/reits/reit-investing-101/a-beginners-guide-to-private-reits-2/.

[5] Nareit. (2021). "REITs by the Numbers." Retrieved July 6, 2021 from https://www.reit.com/data-research/data/reits-numbers.

[6] Frankel, M. (2020). Millionacres. "REIT Statistics: Everything to Know About REITs in 2020." Retrieved July 6, 2021 from https://www.millionacres.com/research/reit-statistics/.

Sydnee Paisner, Marketing Associate, was a contributing author to "Real Estate Investment Trusts"