Introduction to Real Estate Investment Trusts

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Real estate securities

- Reasons for adding real estate in investment portfolio:
  - Real estate is globally the biggest asset
  - Presumption is that real estate has low correlation with the rest of financial securities

- Investing in real estate has several problems
  - Availability
  - Ticket size
  - Management problems

- Hence, intermediated investment through real estate securities came up

- Real estate securities include:
  - REITs
  - REOCs
  - Mortgage-backed securities
  - ETFs/real estate mutual funds
  - Synthetic investment by investing in real estate indices
Meaning of REITs

- A collective investment device of commercial real estate
- Equity-type funding
- REITs versus CMBS:
  - CMBS is securitised debt lending against real estate
  - REITS are security equity funding of real estate
  - REITs
- Owns, and in most cases operates, income-producing property (Equity REITs)
  - Office
  - Apartment
  - Retail (shopping centers)
  - Hotels
  - Warehouses (storage)
- Some REITs also finance real estate (Mortgage REITs)
- Essentially a tax-tool where equity funding of real estate is allowed on tax transparent basis:
  - Minimum 90% dividend
- REITs are typically listed and quoted
REITs have some 34% share in listed property investments.
Commercial real estate as asset class

Exhibit 1: More bricks than bonds
Developed economies' stocks of assets end 2002 ($trillion)

Source: The Economist
Typical REIT structure
REITs and Mutual funds/ collective investment schemes

• While mutual funds may be open-ended, REITs are closed-end funds. As such, REITs are typically listed and their market values may or may not be their NAVs.

• Owing to nature of their assets, computation of NAVs by REITs is different from that by securities mutual funds

• REITs are income-oriented
  ▫ Investors relying on regular income have incentive to invest in REITs
    • Statutorily, REITs distribute substantial part of their taxable profits
Major Player/Capital Sources: Equity:

- REITs are major sources of equity for real estate, mainly commercial real estate today
- JP Morgan Asset management estimates total investment grade, income producing CRE in the USA to be USD 6.4 trillion
  - 3.5 trillion debt
  - 2.9 trillion equity
  - 5.9 trillion private
  - 0.5 trillion public
- of the USD 2.9 trillion equity, approx USD 500 billion is owned by REITs
- Global estimate of investment grade CRE is $26.6 trillion (2011):
  - Europe $9.4 trillion,
  - US/Canada $7.5 trillion
  - Asia-Pacific $7.2 trillion
  - Latin America $1.8 trillion
  - GCC: $677 billion [Prudential Real Estate Investors data]
Suppliers of CRE debt

- 2013 data indicates banks holding 35% CRE debt, followed by CMBS/CDOs holding 23%, GSEs/MBS about 16%

Source:
http://www.reit.com/Portals/0/PDF/CommercialRealEstateGeneralPurpose(10-7-09).pdf
Major Player/Capital Sources: Debt
REITs by country

- The number of REITs globally, end-June 2008 stood at 451 (E&Y 2008 REIT Annual). Down from 484 end 2006.
- In terms of market cap, the most significant REIT countries, in order of significance, are:
  - USA
  - Australia
  - France
  - UK
  - Japan
  - Canada
  - Singapore
  - And so on.
# REITs global data

## REITs data in different countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Market capitalization US$ millions</th>
<th>Total rate of return — one year (%)</th>
<th>Total rate of return — three years (%)</th>
<th>Weighted average dividend yield (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>271,850</td>
<td>27.9</td>
<td>-14.2</td>
<td>5.6</td>
</tr>
<tr>
<td>Australia</td>
<td>70,747</td>
<td>10.4</td>
<td>-25.0</td>
<td>9.7</td>
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<td>France</td>
<td>64,526</td>
<td>45.5</td>
<td>-9.6</td>
<td>0.2</td>
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<td>United Kingdom</td>
<td>37,176</td>
<td>14.5</td>
<td>-26.3</td>
<td>4.6</td>
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<td>Japan</td>
<td>29,432</td>
<td>6.7</td>
<td>-19.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>23,134</td>
<td>85.6</td>
<td>-4.2</td>
<td>8.9</td>
</tr>
<tr>
<td>Canada</td>
<td>20,610</td>
<td>56.2</td>
<td>-3.3</td>
<td>8.1</td>
</tr>
<tr>
<td>Netherlands</td>
<td>11,234</td>
<td>40.9</td>
<td>-6.0</td>
<td>*</td>
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<tr>
<td>Hong Kong</td>
<td>9,518</td>
<td>64.5</td>
<td>9.9</td>
<td>8.1</td>
</tr>
<tr>
<td>Belgium</td>
<td>6,761</td>
<td>17.2</td>
<td>-2.4</td>
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<td>South Africa</td>
<td>3,400</td>
<td>17.5</td>
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<td>New Zealand</td>
<td>2,540</td>
<td>12.7</td>
<td>-4.9</td>
<td>8.4</td>
</tr>
<tr>
<td>Turkey</td>
<td>1,889</td>
<td>151.3</td>
<td>-1.8</td>
<td>*</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1,542</td>
<td>38.6</td>
<td>10.2</td>
<td>3.7</td>
</tr>
<tr>
<td>Germany</td>
<td>713</td>
<td>45.5</td>
<td>N/A</td>
<td>*</td>
</tr>
<tr>
<td>South Korea</td>
<td>132</td>
<td>28.4</td>
<td>12.1</td>
<td>8.4</td>
</tr>
</tbody>
</table>

* Insufficient data for Germany, the Netherlands and Turkey
34 countries have REITs as of 2013
- Number has increased over time as many countries have enacted REIT legislation
- South Africa and Ireland recently passed legislations
- About two dozen more countries are planning to have REITs
- India has come with a draft REIT regulation from SEBI
REITs market cap in the USA

Author’s graph based on data on reit.com
Market capitalisation per REIT

<table>
<thead>
<tr>
<th>Country</th>
<th>Market Capitalisation (US$ millions)</th>
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<tr>
<td>US</td>
<td>1,914</td>
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<tr>
<td>Netherlands</td>
<td>1,872</td>
</tr>
<tr>
<td>UK</td>
<td>1,859</td>
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<tr>
<td>France</td>
<td>1,466</td>
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<td>Hong Kong</td>
<td>1,360</td>
</tr>
<tr>
<td>Australia</td>
<td>1,241</td>
</tr>
<tr>
<td>Singapore</td>
<td>1,157</td>
</tr>
<tr>
<td>Japan</td>
<td>719</td>
</tr>
<tr>
<td>Canada</td>
<td>687</td>
</tr>
<tr>
<td>South Africa</td>
<td>680</td>
</tr>
<tr>
<td>Belgium</td>
<td>451</td>
</tr>
<tr>
<td>New Zealand</td>
<td>317</td>
</tr>
<tr>
<td>Germany</td>
<td>178</td>
</tr>
<tr>
<td>Turkey</td>
<td>145</td>
</tr>
<tr>
<td>Malaysia</td>
<td>129</td>
</tr>
<tr>
<td>South Korea</td>
<td>44</td>
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</table>

US$ millions
### Historical Offerings of Securities
(As of October 31, 2009)

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<thead>
<tr>
<th>Period</th>
<th>Number</th>
<th>Capital Raised&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Number</th>
<th>Capital Raised&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Number</th>
<th>Capital Raised&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Number</th>
<th>Capital Raised&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Number</th>
<th>Capital Raised&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Number</th>
<th>Capital Raised&lt;sup&gt;1&lt;/sup&gt;</th>
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<td></td>
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<tr>
<td>Annual Totals (including current year to date)</td>
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<td></td>
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<td></td>
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<td></td>
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<tr>
<td>2001</td>
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<td>18,752</td>
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<td>0</td>
<td>58</td>
<td>4,204</td>
<td>21</td>
<td>1,878</td>
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<td>9,895</td>
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<td>2,775</td>
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<td>2002</td>
<td>187</td>
<td>19,768</td>
<td>3</td>
<td>608</td>
<td>85</td>
<td>5,785</td>
<td>25</td>
<td>1,991</td>
<td>71</td>
<td>10,638</td>
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<td>2003</td>
<td>228</td>
<td>25,562</td>
<td>8</td>
<td>2,646</td>
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<td>5,471</td>
<td>64</td>
<td>5,192</td>
<td>68</td>
<td>10,894</td>
<td>6</td>
<td>1,358</td>
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<td>2004</td>
<td>266</td>
<td>38,773</td>
<td>29</td>
<td>7,980</td>
<td>79</td>
<td>7,338</td>
<td>61</td>
<td>5,858</td>
<td>97</td>
<td>17,306</td>
<td>0</td>
<td>0</td>
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<tr>
<td>2005</td>
<td>259</td>
<td>38,179</td>
<td>11</td>
<td>3,789</td>
<td>71</td>
<td>8,521</td>
<td>36</td>
<td>3,095</td>
<td>105</td>
<td>16,330</td>
<td>36</td>
<td>5,758</td>
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<tr>
<td>2006</td>
<td>204</td>
<td>49,018</td>
<td>5</td>
<td>2,271</td>
<td>75</td>
<td>15,895</td>
<td>39</td>
<td>4,239</td>
<td>82</td>
<td>25,261</td>
<td>3</td>
<td>1,551</td>
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<tr>
<td>2007</td>
<td>129</td>
<td>36,031</td>
<td>4</td>
<td>1,820</td>
<td>56</td>
<td>11,854</td>
<td>26</td>
<td>4,202</td>
<td>43</td>
<td>18,155</td>
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<td>0</td>
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<tr>
<td>2008</td>
<td>82</td>
<td>17,991</td>
<td>2</td>
<td>491</td>
<td>60</td>
<td>11,132</td>
<td>9</td>
<td>1,195</td>
<td>11</td>
<td>5,173</td>
<td>0</td>
<td>0</td>
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<tr>
<td>2009</td>
<td>114</td>
<td>30,797</td>
<td>8</td>
<td>2,588</td>
<td>81</td>
<td>20,235</td>
<td>0</td>
<td>0</td>
<td>25</td>
<td>7,975</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

From reit.com
REITs by region

## REITs by country

### Total number of REITs by country

<table>
<thead>
<tr>
<th>Global Region</th>
<th>Country</th>
<th>2008</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>United States</td>
<td>148</td>
<td>253</td>
</tr>
<tr>
<td></td>
<td>Canada</td>
<td>33</td>
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<tr>
<td></td>
<td>Netherlands</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>Belgium</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>2</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td>France</td>
<td>48</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Turkey</td>
<td>13</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>19</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td>South Africa</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>EMEIA</td>
<td>Australia</td>
<td>64</td>
<td>58</td>
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<td></td>
<td>New Zealand</td>
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<tr>
<td></td>
<td>Japan</td>
<td>42</td>
<td>38</td>
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<tr>
<td></td>
<td>Hong Kong</td>
<td>7</td>
<td>4</td>
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<tr>
<td></td>
<td>South Korea</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>Malyasia</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>Singapore</td>
<td>20</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>451</td>
<td>484</td>
</tr>
</tbody>
</table>
Market size and depth

Market capitalization – total

<table>
<thead>
<tr>
<th>Country</th>
<th>US$million</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>294,612</td>
</tr>
<tr>
<td>Australia</td>
<td>78,110</td>
</tr>
<tr>
<td>France</td>
<td>72,817</td>
</tr>
<tr>
<td>UK</td>
<td>41,437</td>
</tr>
<tr>
<td>Japan</td>
<td>38,089</td>
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<tr>
<td>Canada</td>
<td>22,399</td>
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<tr>
<td>Singapore</td>
<td>19,514</td>
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<td>Netherlands</td>
<td>12,202</td>
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<td>Hong Kong</td>
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<td>New Zealand</td>
<td>2,790</td>
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<td>South Africa</td>
<td>2,418</td>
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<td>Turkey</td>
<td>1,665</td>
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<tr>
<td>Malaysia</td>
<td>1,520</td>
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<tr>
<td>Germany</td>
<td>1,005</td>
</tr>
<tr>
<td>South Korea</td>
<td>410</td>
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</tbody>
</table>

Source: E&Y 2008 REITs annual

Presentation on REITs by Vinod Kothari
REITs in certain countries

- USA: REITs have been there since 1960 when tax rules were amended to permit REITs
  - Apart from listed REITs, there are many unlisted REITs (about 1100)
- UK – REITs were a recent introduction. Provisions were contained in Finance Act 2006 permitting property companies to transform into REITs
- Australia- they are known as listed property trusts and have been in existence for several years
- China: has taken an in-principle decision but REITs yet to be a reality in China
Geographical distribution of REITs

Breakdown of Global REIT market as at 30th April 2007 by region

North America 54.5%
Europe 12.3%
UK 8.7%
Far East 10.4%
Africa 0.4%
Oceania 13.7%

Source: AME Capital / Bloomberg
REITs returns

- Till 2008, REITs performed very badly due to global property meltdown
- In 2009, REITs have been recovering
  - Though in most cases they are still below 2007 values

S&P REIT quarterly report Q3 2009
Performance of REITs

DJ Global Select REIT index
Comparative REITs performance

Historical compound annual total returns of the FTSE NAREIT All REIT Index, FTSE NAREIT Equity REIT Index and leading U.S. benchmarks:

<table>
<thead>
<tr>
<th></th>
<th>FTSE NAREIT All REIT</th>
<th>FTSE NAREIT Equity REIT</th>
<th>S&amp;P 500</th>
<th>Russell 2000</th>
<th>Nasdaq Composite(^1)</th>
<th>Dow Jones Ind Avg(^1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>17.73</td>
<td>17.00</td>
<td>19.26</td>
<td>22.43</td>
<td>34.58</td>
<td>10.66</td>
</tr>
<tr>
<td>1-Year</td>
<td>-25.29</td>
<td>-28.40</td>
<td>-6.91</td>
<td>-9.55</td>
<td>1.46</td>
<td>-10.49</td>
</tr>
<tr>
<td>3-Year</td>
<td>-12.71</td>
<td>-12.39</td>
<td>-5.43</td>
<td>-4.57</td>
<td>-2.05</td>
<td>-5.96</td>
</tr>
<tr>
<td>5-Year</td>
<td>0.23</td>
<td>1.40</td>
<td>1.02</td>
<td>2.41</td>
<td>2.27</td>
<td>-0.74</td>
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<td>10-Year</td>
<td>9.12</td>
<td>9.53</td>
<td>-0.15</td>
<td>4.88</td>
<td>-2.54</td>
<td>-0.62</td>
</tr>
<tr>
<td>15-Year</td>
<td>8.70</td>
<td>9.12</td>
<td>7.62</td>
<td>7.33</td>
<td>7.05</td>
<td>6.38</td>
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<td>20-Year</td>
<td>8.34</td>
<td>9.22</td>
<td>8.00</td>
<td>7.87</td>
<td>7.80</td>
<td>6.62</td>
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<tr>
<td>25-Year</td>
<td>8.05</td>
<td>9.98</td>
<td>10.36</td>
<td>8.95</td>
<td>8.93</td>
<td>8.70</td>
</tr>
<tr>
<td>30-Year</td>
<td>9.73</td>
<td>11.26</td>
<td>11.02</td>
<td>10.35</td>
<td>9.23</td>
<td>8.34</td>
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<tr>
<td>35-Year</td>
<td>11.66</td>
<td>13.37</td>
<td>11.83</td>
<td>NA</td>
<td>9.53</td>
<td>6.96</td>
</tr>
</tbody>
</table>
Indicators of leverage

- Most REITs make use of leverage
- If REITs are tax transparent, use of leverage is akin to use of debt in a tax-free world
- Significance debt/assets ratios in some countries (2008):
  - Canada 0.69
  - USA: 0.64
  - South Korea 0.56
  - Germany 0.52
  - France 0.49
  - Japan 0.48
  - Netherlands 0.47
  - Australia 0.45
REITs leverage data

![Bar chart showing total debt to gross assets as of 31 December 2009 for various countries, including Canada, Germany, US, UK, France, Belgium, Japan, South Korea, Netherlands, Australia, Singapore, New Zealand, Hong Kong, Malaysia, South Africa, and Turkey. The chart compares the debt structure, with some countries represented in yellow indicating property carried at cost and in gray indicating property carried at fair value.](chart_image)
The difference may be explained by accounting differences – under US GAAP investment property is held at cost, while under IAS 40, revaluation model is permitted.
Measure of volatility

![Bar chart showing BETA values for various countries: South Africa (0.35), South Korea (0.41), Japan (0.43), Belgium (0.46), New Zealand (0.51), France (0.52), Singapore (0.54), Australia (0.55), Netherlands (0.57), Malaysia (0.58), Canada (0.63), United States (0.89).]
Where did REITs come from?

- REIT is essentially a tax term
- Created in 1960 (act of Congress) as a way to make property investment available to individual investors
  - Offer expert management and familiar corporate governance structures (BOD)
- REITs make equity interest in commercial property:
  1. Divisible into shares that can be purchased by small investors
  2. LIQUID – the shares trade on major exchanges
REITs as a force in the CRE finance

- In USA, about 15-20% of investment grade CRE is held by REITs
- About 24000 properties
- 169 REITs trade on NYSE
- 35 REITs are in S&P 500
REITs in different countries

- Many countries have adopted a REIT-type structure:
  - France - SIIC
  - LPT - Listed Property Trusts (Australia)
  - Dutch FBI - Fiscal Beleggings Instelling (Netherlands)
  - S-REIT – Singapore Real Estate Investment Trust
  - J-REIT - Japanese Real Estate Investment Trust
  - Canadian REITs – Legislated in 1993, growing universe
  - Belgium REITs – Growing universe
  - Hong Kong REITs – Largest REIT IPO Completed in November 2005
  - Bulgarian REITs – Newest country with REIT legislation
  - Malaysian REITs – Growing universe
  - Property unit trusts – South Africa
  - UK Finance Act 2006 has provided for conversion of qualifying companies into REIT status from 2007
Types of REITs

- **Equity REITs**
  - Own and operate income-producing real estate
  - Perform leasing, development, and construction activities
    - As of 31.12.2005, 152 publicly traded equity REITs, with market cap of $301 billion, about 90% of the market

- **Mortgage REITs**
  - Hold mortgages on real property
    - Make mortgages (lend money), usually on existing property
    - Buy mortgages
    - 27 publicly traded mortgage REITs

- **Hybrid REITs**
  - Both own properties and make loans
    - 8 publicly traded Hybrid REITs
Types of REITs – by property

Listed REITs Invest In All Property Types

- Health Care: 13%
- Industrial Facilities: 4%
- Mixed (Industrial & Office): 3%
- Office Buildings: 11%
- Regional Malls: 8%
- Shopping Centers: 11%
- Self Storage: 8%
- Lodging/Resorts: 4%
- Diversified: 7%
- Hybrid: 1%
- Mortgage: 7%
- Specialty: 7%
- Manufactured Homes: 1%
- Apartments: 13%

Listed REITs as of Jan 8, 2009
Source: NAREIT*
Why investors invest in REITs

- Diversification
  - Asset allocation objectives puts real estate as a must
- Dividends
- Liquidity
- Performance
- Liquidity
- Real property backing
Components of REITs total returns

FTSE NAREIT Equity REITs Return Components
(Percent change, as of December 31, 2008)

- Average Annual Income Returns: 8.30%
- Average Annual Total Returns: 11.20%

Source: NAREIT
Performance of REITs

**REITs Measure Up Over Time**

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Dow Jones Industrials</td>
<td>6.38%</td>
</tr>
<tr>
<td>NASDAQ Composite</td>
<td>7.36%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>9.49%</td>
</tr>
<tr>
<td>Equity REITs (publicly traded)</td>
<td>11.21%</td>
</tr>
</tbody>
</table>

Source: NAREIT®
Past performance is no guarantee of future results.
Correlation of real estate and financial securities

REITs Have Become Inextricably Linked to Financials Since 2007

Trailing 36-month Correlation

* Based on monthly price-only return data

Ibbotson Associates; S&P; FTSE NAREIT
Portfolio allocation by REITs

• Geographical diversification
  ▫ Unlike financial markets, property markets have a weak global correlation
    • Global property diversification is not possible for an individual investor

• Stress on income vs market value:
  ▫ Dividend payout is one of the characteristics of REITs

• Property type
Investing in REITs

- General desire to have a portion of assets in real estate
  - Typically, 8-10% real asset allocation
- A diversified investment in bricks
- Weaker correlation with financial securities
  - Asset price bubbles may be a cause for concern
- Dividends:
  - REIs distribute more regular income – why?
- Exchange-traded funds investing in REITs indices may allow investors to take an exposure in a REITs index
- Hedge against properties:
  - If you are holding property, and want to sell it in future, you may short REITs index
  - If you wanting to buy property, you may long REITs index
- Allows investors to take a view on property price indices
- Have produced better returns than private investment in real estate (next slide)
- Downsides:
  - REITs are, however, more volatile than property prices (due to public trading) (see slide)
  - REITs have relatively higher correlation with equities than real estate prices
Distinctive features of investing in REITs

- Is it an income stock or growth stock
  - REITs are essentially income stocks:
    - Dividend restrictions
    - Mostly, REITs will invest in mature income producing properties
    - REITs in most countries are not allowed to get into development
REIT returns (NAREIT index) versus private investment in property returns (NCREIF index)
NAVs and REIT values

Source: E&Y 2008 REIT annual
REITs versus NCREIF - volatility

REITs vs NCREIF returns

Presentation on REITs by Vinod Kothari
Other real estate investment vehicles

- Direct investment properties
- Property funds:
  - Closed-end funds
  - Open-end funds
- REIT ETFs
- Property derivatives:
  - Total return swaps linked to properties
  - Swaps linked to property indices
- Housing futures
  - For example, CME Housing futures
  • On S&P Case Schiller Home price index
- CMBX
Real estate price correlations

<table>
<thead>
<tr>
<th></th>
<th>US</th>
<th>Canada</th>
<th>UK</th>
<th>Netherlands</th>
<th>France</th>
<th>Japan</th>
<th>Australia</th>
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</thead>
<tbody>
<tr>
<td><strong>US</strong></td>
<td><strong>1.00</strong></td>
<td>0.77</td>
<td>0.43</td>
<td>0.47</td>
<td>0.57</td>
<td>0.31</td>
<td>0.46</td>
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<tr>
<td><strong>Canada</strong></td>
<td>0.77</td>
<td><strong>1.00</strong></td>
<td>0.46</td>
<td>0.48</td>
<td>0.59</td>
<td>0.37</td>
<td>0.57</td>
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<tr>
<td><strong>UK</strong></td>
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<td><strong>1.00</strong></td>
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<td>0.67</td>
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<td>0.48</td>
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<tr>
<td><strong>Netherlands</strong></td>
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<tr>
<td><strong>France</strong></td>
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<td><strong>1.00</strong></td>
<td>0.32</td>
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</tr>
<tr>
<td><strong>Japan</strong></td>
<td>0.31</td>
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<td>0.31</td>
<td>0.37</td>
<td>0.32</td>
<td><strong>1.00</strong></td>
<td>0.23</td>
</tr>
<tr>
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<td>0.46</td>
<td>0.57</td>
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<td>0.56</td>
<td>0.49</td>
<td>0.23</td>
<td><strong>1.00</strong></td>
</tr>
</tbody>
</table>
Parameters in evaluating a REIT investment

• Price to FFO:
  ▫ REITs price/FFO is generally lower than corporate P/E ratios:
    • Is this justified?

• Price to NAV:
  ▫ Depending on the cycle, REITs may be trading at premium on NAV or discount on NAV
    • For last several years, REIT prices have been trading at premium on NAV

• Scale:
  ▫ Smaller REITs will not be able to achieve diversification and economies of scale

• Vertical integration
  ▫ Property groups with development, management and financing activities are generally preferred
Growth opportunities

• How does a REIT grow?
• Since there are dividend distribution requirements, REITs cannot grow the way corporates grow
• Hence, REITs have to continuously look for:
  ▫ Capital issuance
  ▫ Debt issuance
    • Leverage is also limited
      • If the REIT is already fully geared, it cannot use further debt
  ▫ Hence, ability to issue further capital becomes critical
REIT Structures – UPREITs and Traditional REITs

- **UPREIT (Umbrella Partnership REIT)**
  - First UPREIT was Taubman Realty IPO in 1992
  - UPREIT structure created to shield owners contributing real estate assets to the REIT from capital gains taxes on contributed property
    - Transfer is then partnership shares for partnership shares, and this is not a taxable event for the owners
  - UPREIT owns a controlling interest in a limited partnership that owns the real estate, as opposed to a traditional REIT structure in which the REIT owns the real estate
  - The Umbrella Partnership “shares” – known as operating partnership units, or OP units – are convertible into REIT shares and enjoy voting rights and dividends just like REIT shares
    - Convertibility allowed after one year, and triggers taxes
REITs and Taxes

- REITs do not have to pay federal taxes at the corporate level
  - More specifically, REITs are allowed to deduct dividends paid to shareholders from taxable income, and thus have the ability to shield 100% of taxable income through distributions to shareholders
    - No other firm in the economy can deduct dividends
  - REIT shareholders still have to pay taxes on dividends and capital gains
  - Most states honor the REIT status and don’t require REITs to pay state taxes
Tax restrictions on REITs

- Taxed in such a way that they usually distribute all their income.
- Must be owned by at least 100 people, no more than 50% of equity
- Must derive at least 75 percent of gross income from rents from real estate or interest on mortgages on property
- Must invest at least 75 percent of its total assets in real estate assets
- 1031 exchange not allowed for investors

Presentation on REITs by Vinod Kothari
US rules for taxation of REITs

- **Asset Test:**
  - At least 75% of a REIT’s asset value must come from real estate, cash, and government securities at the close of each quarter of taxable year
  - No more than 5% of the value of the assets may consist of the securities of one issuer, and REIT may not own more than 10% of the outstanding shares of one issuer, if those securities are not includable in the 75% test

- **Income Test:**
  - At least 95% of gross income must come from dividends, interests, rents, or gains from sale of certain assets
  - No more than 30% of REITs gross income can be derived from sale of real estate held for less than four years or securities held for less than six months

- **Distribution Test:**
  - At least 90% of the REIT taxable income must be distributed to shareholders

- **Stock and Ownership Test:**
  - REIT shares must be transferable and must be held by a minimum of 100 persons
  - No more than 50% of REIT shares may be held by five or fewer persons
Reporting by REITs

- **Funds from operations**
  - GAAP income
  - Excluding gains or losses from sale of property
  - Plus historical cost amortization of properties
  - Less future taxes

- **Adjusted funds from operations**
  - FFO minus recurring capital expenditure to maintain the property
  - Straight-lining of rentals

- **FFO and GAAP income reconciliation**