NAI Realvest®

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CRE Terms: Let’s Talk REITs!

Our focus today is on an asset class that has shown strong returns for investors historically, namely Real Estate Investment Trusts or REITs. For many first-time investors, REITs represent an attractive opportunity to get a foot into the real estate market. They typically pay out high dividends while allowing investors to diversify their portfolio.

Though the REITs market has taken some knocks in the first half of 2022, like any sector, it pays to stay on top of the terminology. With that in mind, let’s talk REITs!

REITs Essentials

According to Nareit, a REIT is: “a company that owns, operates or finances income-producing real estate across a range of property sectors.”

They add that, by allowing members of the public to buy into their real estate portfolios, these companies make real estate investing more accessible and give a broad range of investors access to dividend-based income from a property.

Types of REITs

REITs that own and operate properties are called equity REITs and the types of properties they focus on varies widely. There are specific trusts for everything from multifamily and office, to industrial, retail, hospitality and healthcare facilities. Newer offerings are even more specific, focusing on niche but growing industries like veterinary care.

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Nareit adds: "Because most REITs operate as equity REITs when the market refers to REITs it is typically discussing listed equity REITs."

When companies focus on the financing side, rather than ownership and management of the properties themselves, these operators are called mortgage REITs, or mREITs. Revenue is generated through interest earned on investments into mortgages or mortgage-backed securities.

UPREITs, DownREITs

For those who already own property, Umbrella Partnership REITs or UPREITs offer a chance to diversify their investment portfolio without triggering a taxable event. In this case, ownership of the property is transferred to a REIT and the original owner receives operating partnership units (OP Units) equal in value to the REIT's stock.

As Motley Fool explains: "By accepting the OP units in the REIT instead of cash, the property owner can defer paying capital gains taxes until they sell the partnership units, convert them into REIT shares or the OP sells the contributed property. This ability to defer taxes makes an UPREIT similar to using a section 1031 exchange."

An added benefit of trading into an UPREIT is that the investor is freed from the more "hands-on" elements of property management and maintenance.

Finally, a property owner can transfer their assets to a downREIT partnership that only includes those assets. Essentially, they're entering into a joint venture with the REIT using their properties.

In this case, however, they don't get the benefit of diversification. As the Certified Commercial Investment Member (CCIM) Institute puts it: "A downREIT transaction probably is most appropriate when the property owner believes that his property will outperform the rest of the REIT's portfolio."

The diversity of REIT options available means that despite a tough start to 2022, this versatile asset class is likely to stay on investors' radars.