REITs

REITs are a form of a real estate investment tool that possibly reduces taxes by providing potential distributions that are partially tax favored. REITs are usually owned by companies that own and operate income-producing real estate, or related assets. There are three different types of REITs, Non-Traded REITs, Equity REITs and Mortgage REITS.

- **Non-Traded REITs**

  All non-traded REITs are governed by the Securities and Exchange Commission and the Internal Revenue Service. To operate a non-traded REIT, you must be a taxable corporation, managed by a board of directors. At least 75% of the assets held must be real estate investments, and there must be at least 100 shareholders. The reason non-traded REITs can become very appealing to long term investors is that they are required to pay at least 90% of taxable income to its shareholders. This potential distribution makes non-traded REITs appealing to those who are looking for tax favored treatment of dividends.

- **DEFINITION of 'Non-Traded REIT'**

  A non-traded REIT is a form of real estate investment method that is designed to reduce or eliminate tax while providing returns on real estate. A non-traded REIT does not trade on a securities exchange and because of this, it is quite illiquid for long periods of time. Front-end fees can be as much as 15%, much higher than a traded REIT due to its limited secondary market. However, recently the fees have begun to come down and some REITS have been formed to provide monthly or even quarterly redemption options.

- **BREAKING DOWN 'Non-Traded REIT'**

  Early redemption of a non-traded REIT can result in high fees (surrender penalties) that can lower the total return. Like exchange-traded REITs, non-traded REITs are subject to the same IRS requirements that include returning at least 90% of taxable income to shareholders. Investors tend to seek exchange-traded and non-traded REITs for their income distribution.

- **Common Considerations When Investing in a Non-Traded REIT**

  Non-traded REITs could remain illiquid after their inception for up to eight years or even longer because they are not traded on national exchanges and may not have steady income at the beginning. Periodic distributions to shareholders of non-traded REITs may be largely subsidized by borrowed funds. Such distributions are not guaranteed to be paid and may exceed the REIT’s operating cash flow. The board of directors for the non-traded REIT can decide whether or not to pay a distribution and what amount will be given. When a non-traded REIT is just getting started, its earliest distributions might come entirely from the capital the investors put into it. The expectation is that the REIT will eventually see income that is generated by the real estate it has invested in. This income would likely come from the properties through rent, leases or hotel fees. The types of properties that a non-traded REIT invests in early on might be unknown to the investors. The initial property acquisitions might be made through a blind pool, where the investors do not know the specific properties that are being added to the program’s portfolio.

Despite not being listed on any national securities exchanges non-traded REITs must still be registered with the Securities and Exchange Commission. They are also required to make regular, periodic regulatory filings. This includes quarterly and annual reports as well as filing a prospectus.

Many non-traded REITs are structured with a finite timeframe built in before one of two actions must be taken. At the end of the period, the non-traded REIT must either become listed on a national exchange, or it must liquidate. The liquidation can come through property sales or a purchase by another REIT or pension funds or anyone looking to purchase the properties or portfolio of that REIT. The value of the investment made into such an REIT could have decreased or become worthless at the time the program is liquidated.

- **Equity REITs**

  Equity REITs make up almost all the REIT investing market. They take an ownership position in the properties and collect the rent and manage the properties in hopes of increasing the value of the property over time. Equity REITs are very favorable because the money gets paid to investors from the profit of rental properties, however, sometimes the property values can decline and sometimes quite substantially.

- **Mortgage REITs**

  Mortgage REITs are the least common of the three because they have a high risk. They borrow money at short term interest rates, and the loans those dollars to the over and operators of real estate. The Mortgage REIT makes money on the interest accrued from these loans.