



Introduction to Real Estate Investment Trusts

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Real estate securities



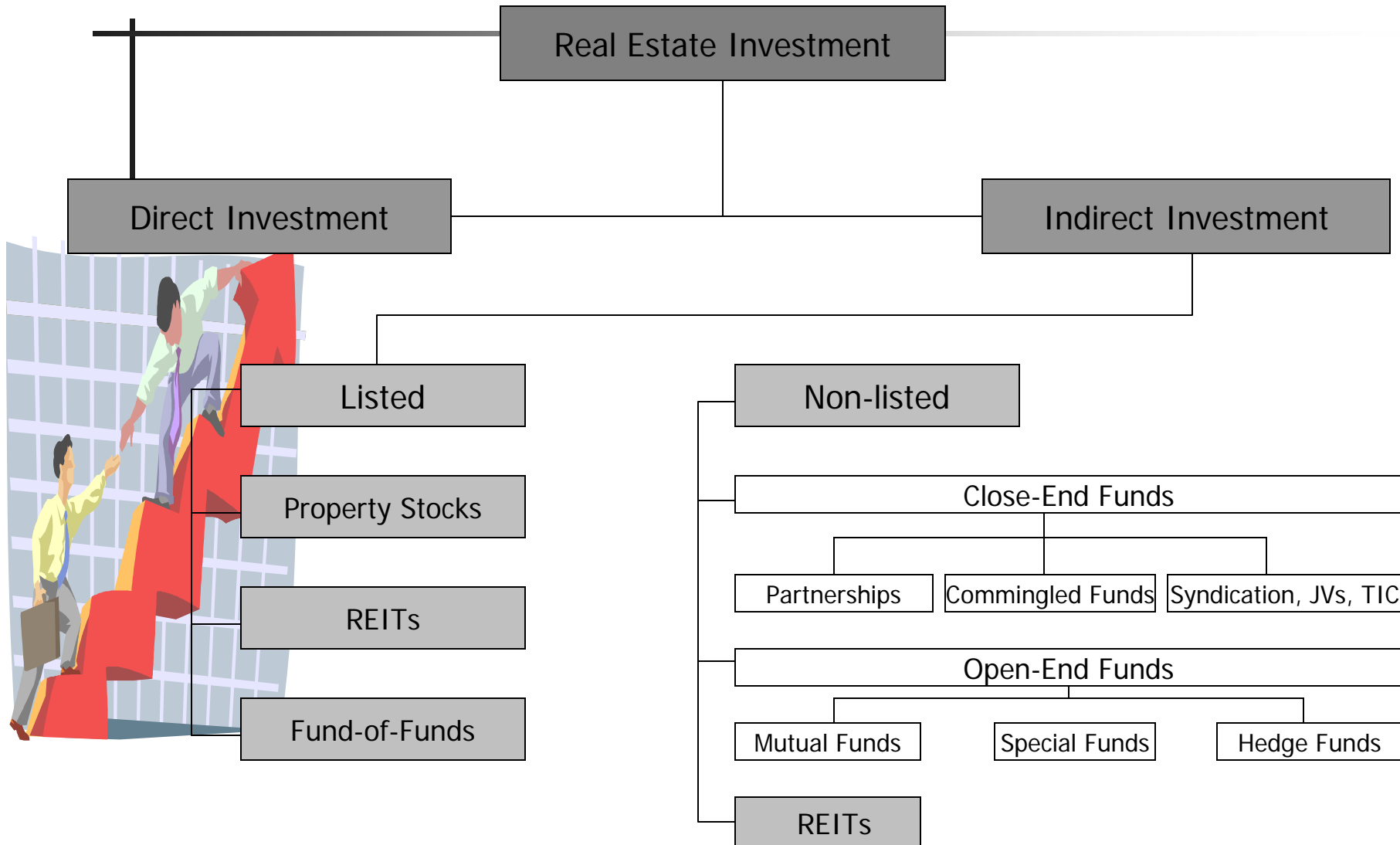
- Reasons for adding real estate in investment portfolio:
 - Real estate is globally the biggest asset
 - Presumption is that real estate has low correlation with the rest of financial securities
- Investing in real estate has several problems
 - Availability
 - Ticket size
 - Management problems
- Hence, 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



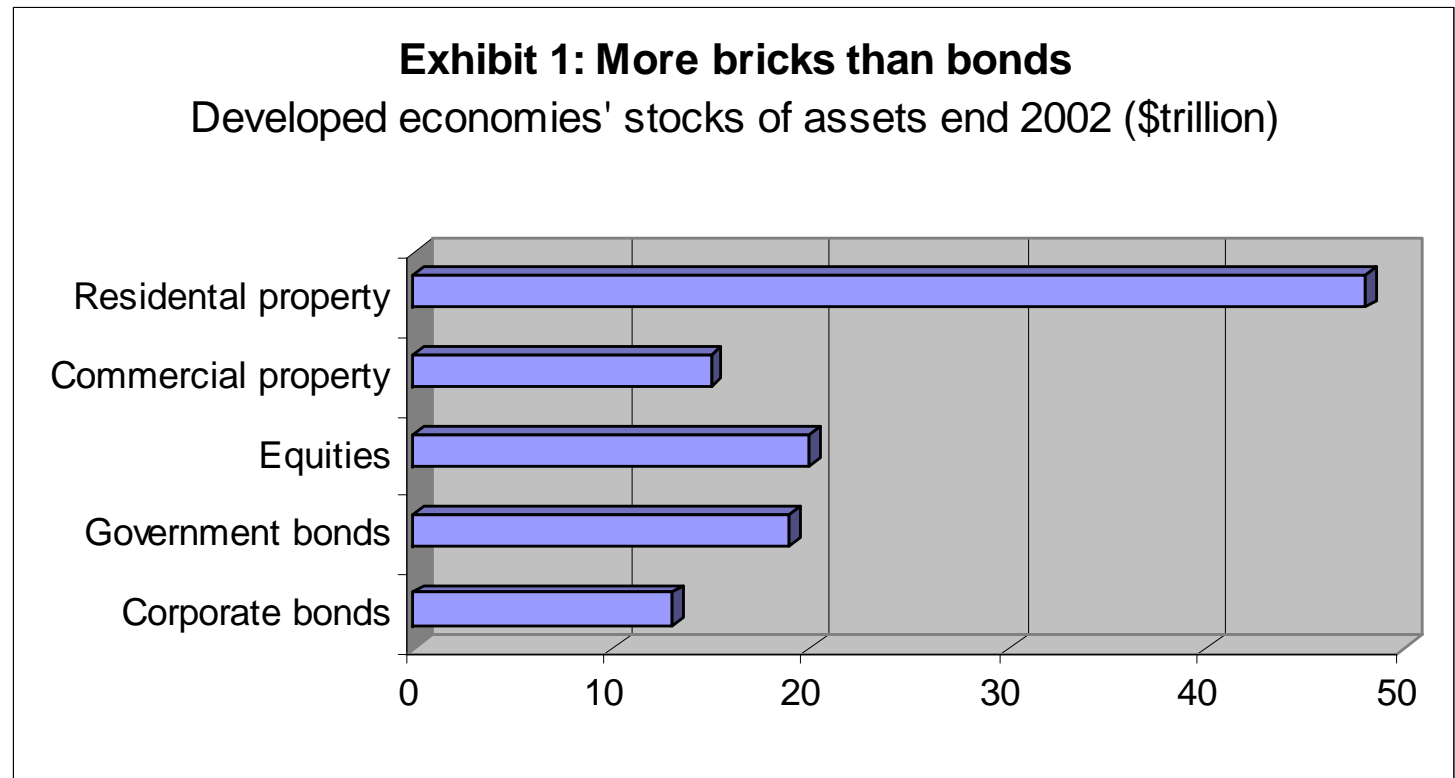
- A collective investment device of commercial real estate
- Equity-type funding
- REITs versus CMBS:
 - CMBS is securitised debt lending against real estate
 - REITs are security equity funding of real estate
 - REITs
- Owns, and in most cases operates, income-producing property (Equity REITs)
 - Office
 - 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 as property investment vehicle



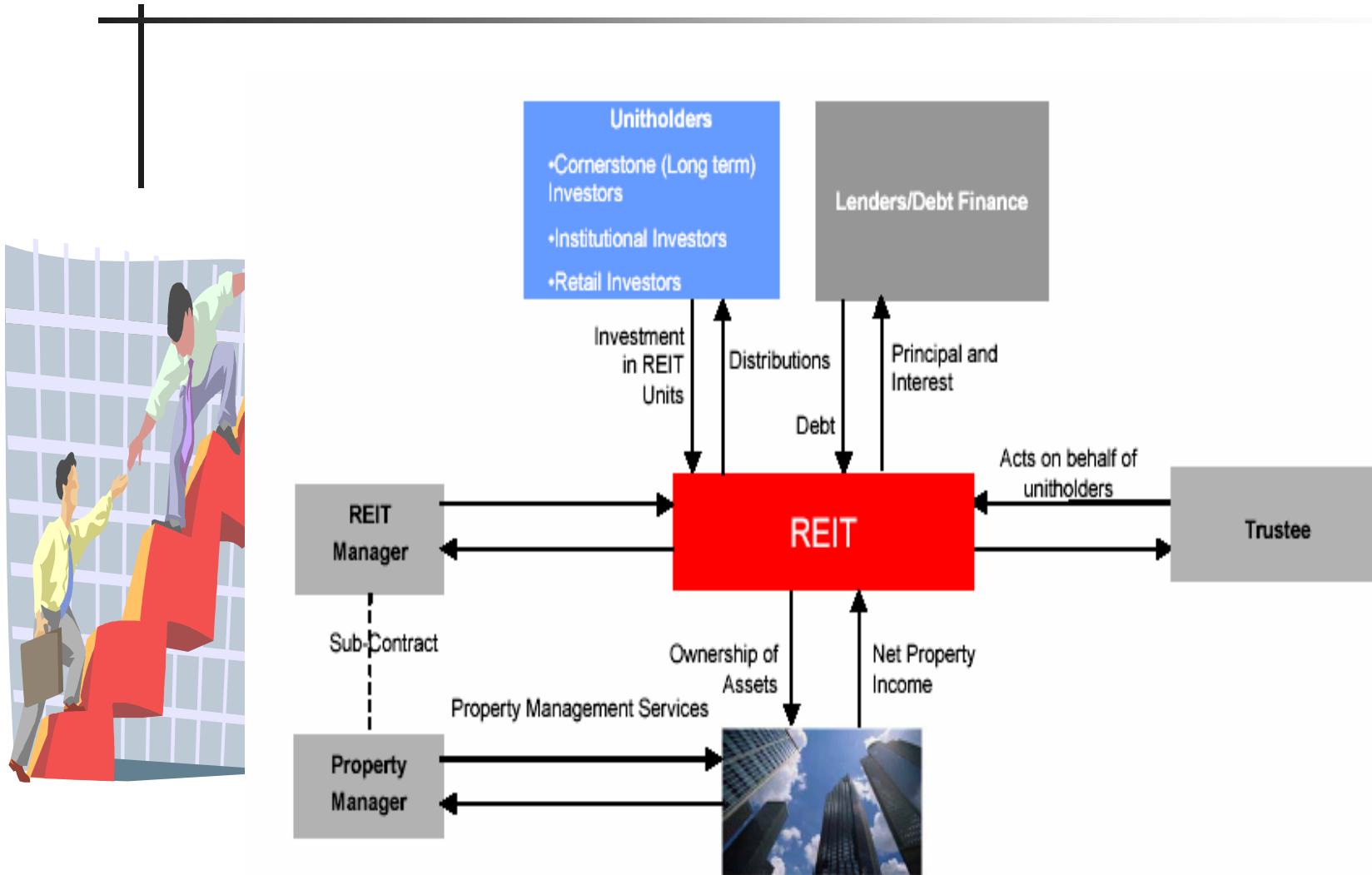
REITs have some 34% share in listed property investments.

Commercial real estate as asset class



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:

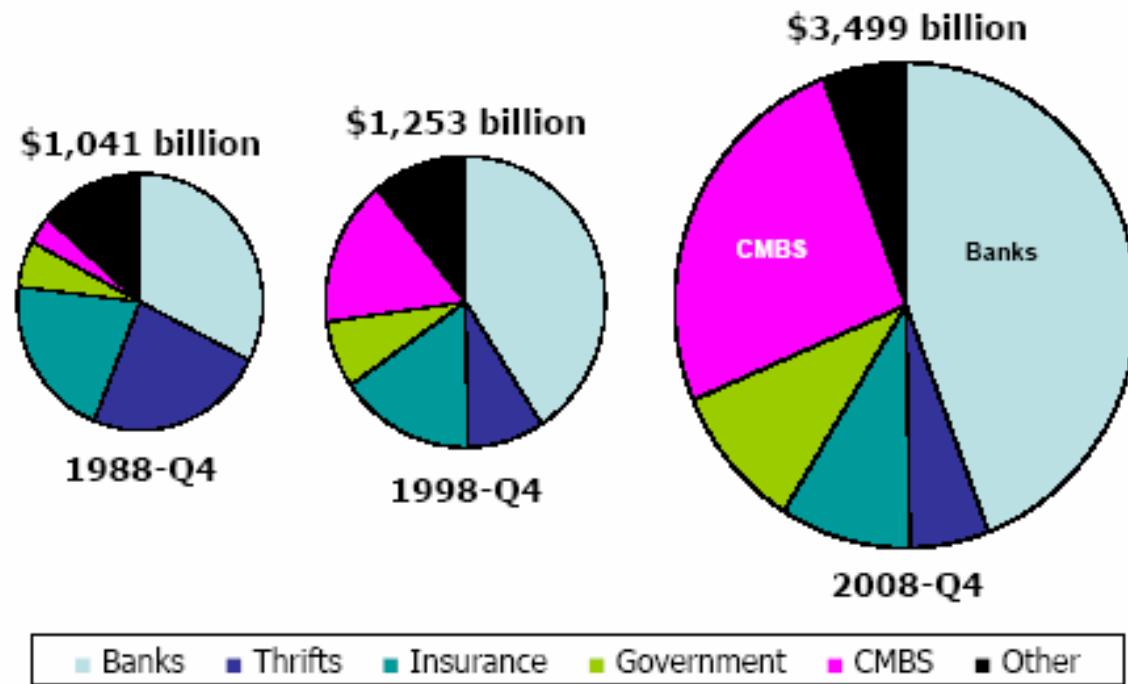


- REITs are major sources of equity for real estate, mainly commercial real estate today
- JP Morgan Asset management estimates total investment grade, income producing CRE to be USD 6.4 trillion
 - 3.5 trillion debt
 - 2.9 trillion equity
 - 5.9 trillion private
 - 0.5 trillion public
- of the USD 2.9 trillion equity, approx USD 500 billion is owned by REITs

Suppliers of CRE debt



Commercial Mortgage Debt Outstanding By source of funds

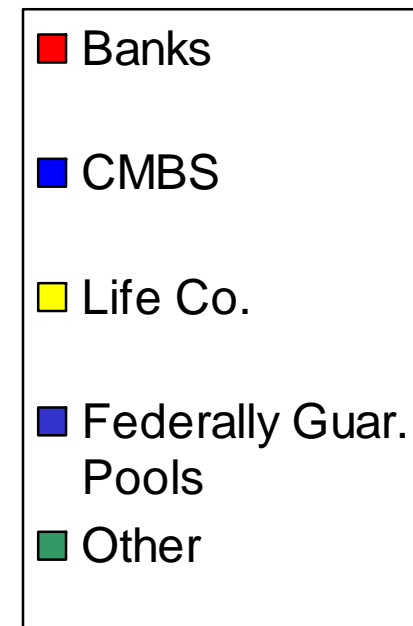
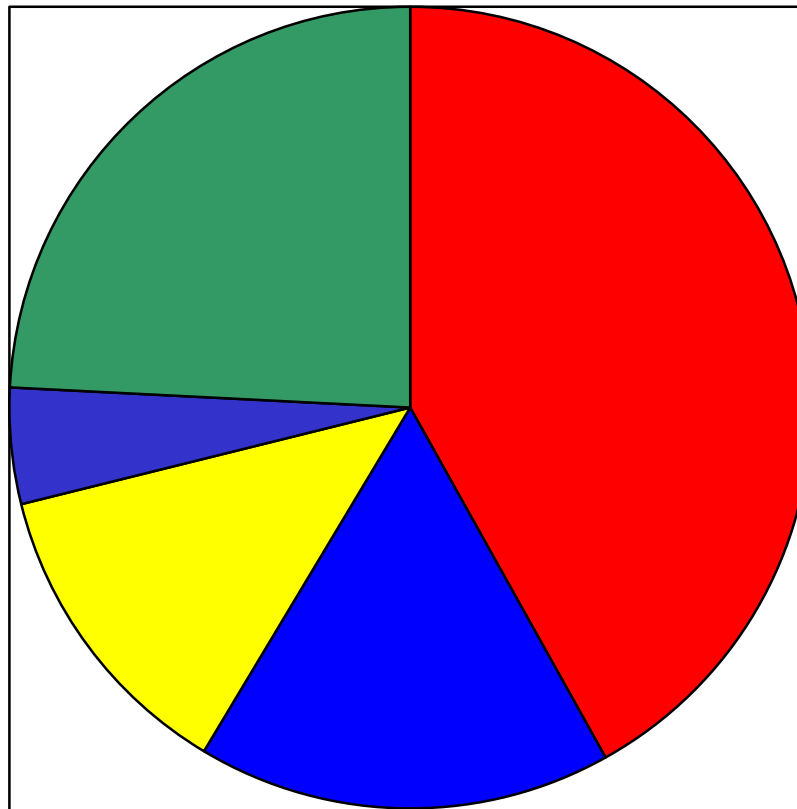


Source:

[http://www.reit.com/Portals/0/PDF/CommercialRealEstateGeneralPurpose\(10-7-09\).pdf](http://www.reit.com/Portals/0/PDF/CommercialRealEstateGeneralPurpose(10-7-09).pdf)

Vinod Kothari REITs 2009

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
- Decline mostly accountable by US debacle – number down from 253 in 2006 to 148 in 2008
- 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 market cap over years



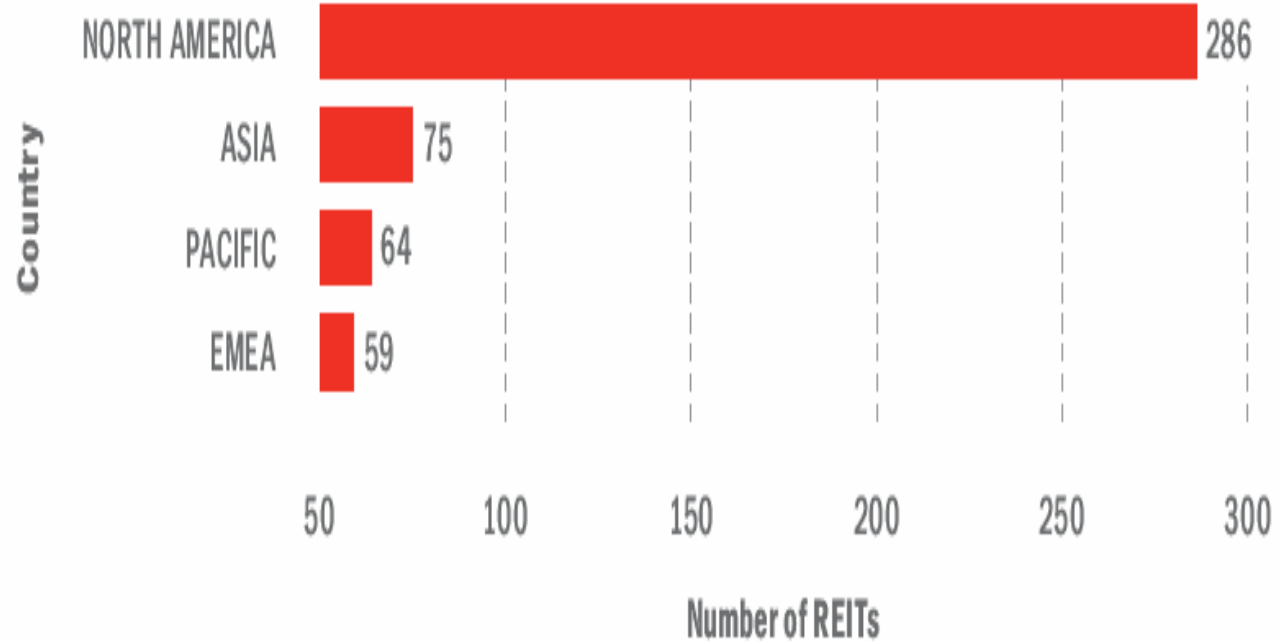
Source: U.S. REITs: FTSE NAREIT Composite Index; Global REITs: FTSE EPRA/NAREIT Global Real Estate Index

- 24 countries have REITs as of end-2006.
- About two dozen more countries are planning to have REITs
- India introduced real estate mutual funds – a concept that has not picked up as yet

REITs by region



Total REITs by Region



Source: EY's Global REIT report Oct 2006

REITs by country

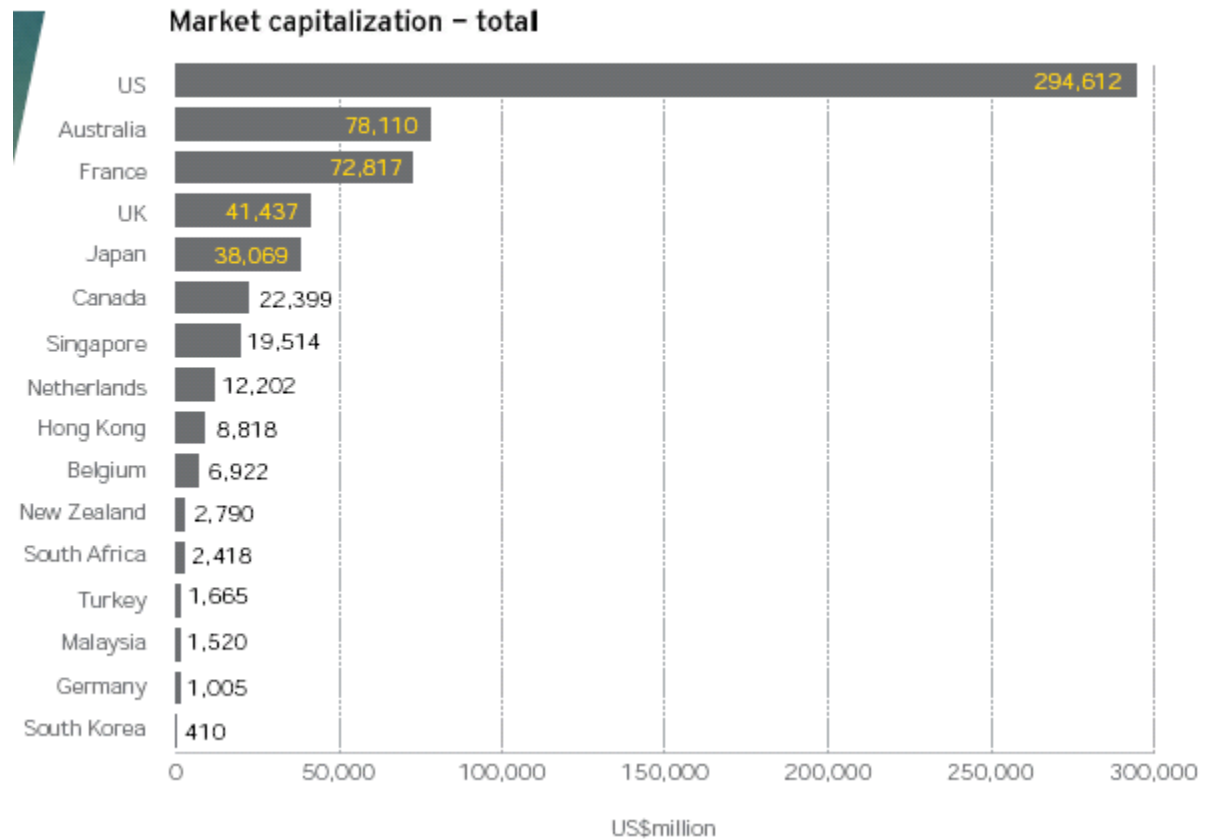


Total number of REITs by country			
Global Region	Country	2008	2006
North America	United States	148	253
	Canada	33	33
EMEIA (EMEIA is a global region made up of Europe, Middle East, India and Africa. Note Indian REITs have not been analyzed in this report.)	Netherlands	8	9
	Belgium	14	13
	Germany	2	NA
	France	48	30
	Turkey	13	NA
	United Kingdom	19	NA
	South Africa	6	7
Pacific	Australia	64	58
	New Zealand	8	6
Asia	Japan	42	38
	Hong Kong	7	4
	South Korea	6	11
	Malaysia	13	11
	Singapore	20	11
Total		451	484

Market cap by country



Market size and depth



Source: E&Y 2008 REITs annual

REITs in certain countries

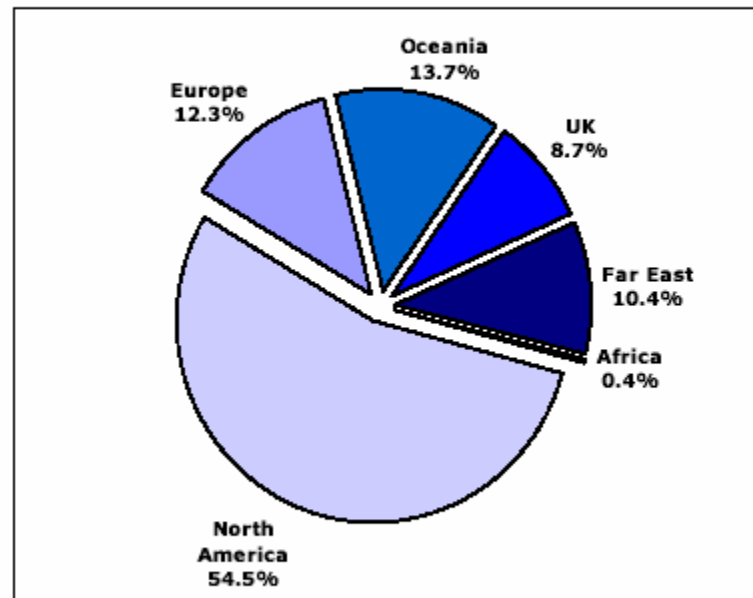


- USA: REITs have been there since 1960 when tax rules were amended to permit REITs
 - Apart from listed REITs, there are many unlisted REITs (about 1100)
- UK – REITs were a recent introduction. Provisions were contained in Finance Act 2006 permitting property companies to transform into REITs
- Australia- 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



Source: AME Capital / Bloomberg

REITs returns

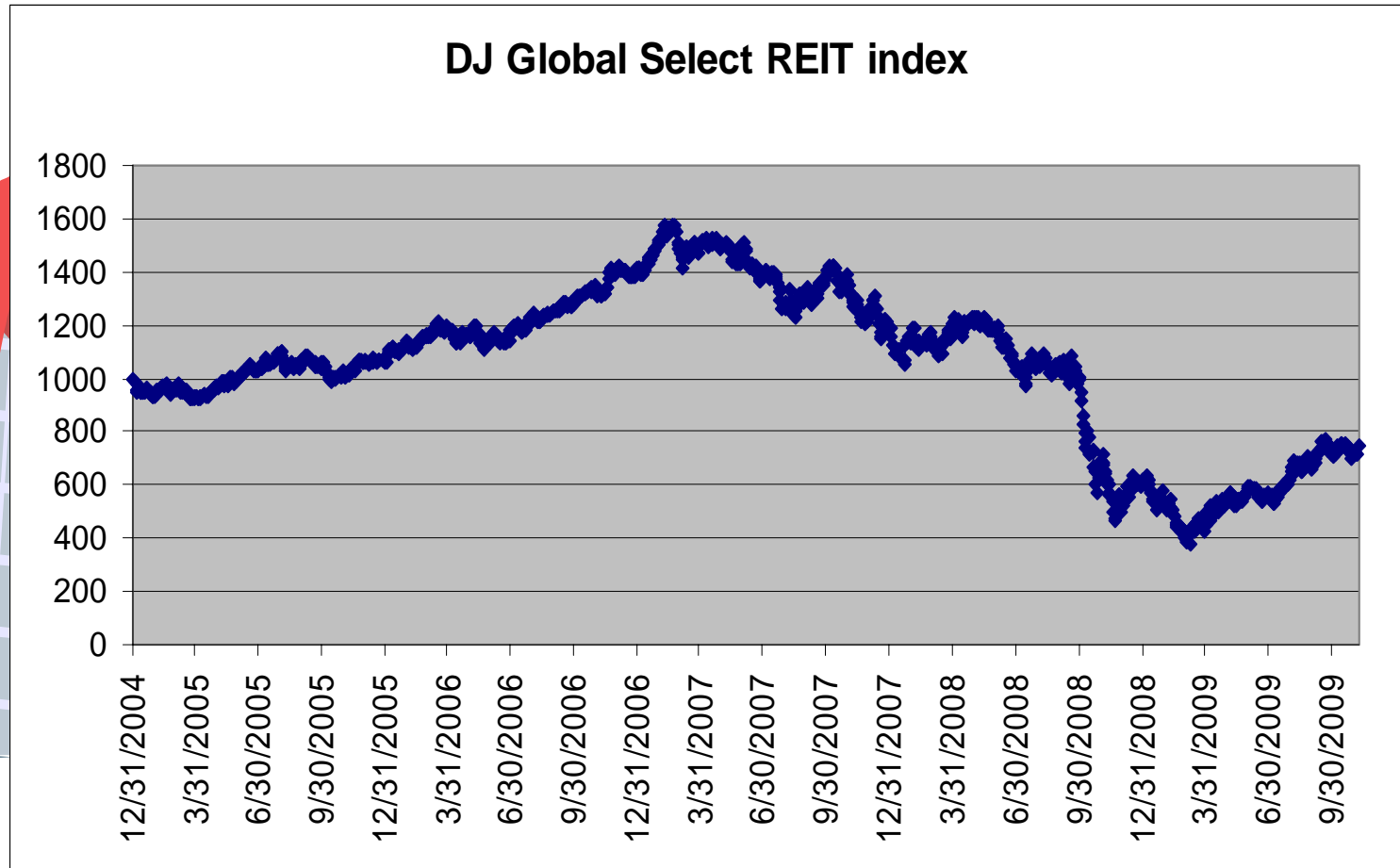
- Till 2008, REITs performed very badly due to global property meltdown
- In 2009, REITs have been recovering
 - Though in most cases they are still below 2007 values



S&P Global REIT Index	Global	Developed	Emerging	North America	U.S.	Europe	Asia Pacific
3rd Quarter	32.70%	32.96%	12.75%	34.44%	34.52%	34.28%	29.76%
YTD	27.55%	27.44%	36.13%	19.30%	17.80%	35.95%	39.59%
1-Year	-18.15%	-18.51%	27.24%	-27.31%	-28.22%	-11.66%	-0.70%
3-year annualized	-11.21%	-11.38%	10.56%	-12.41%	-12.86%	-12.35%	-8.36%
5-year annualized	2.14%	2.05%	NA	1.63%	1.27%	4.87%	2.01%
10-year annualized	10.19%	10.14%	NA	9.87%	9.73%	12.29%	9.23%

S&P REIT quarterly report Q3 2009

Performance of REITs



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:



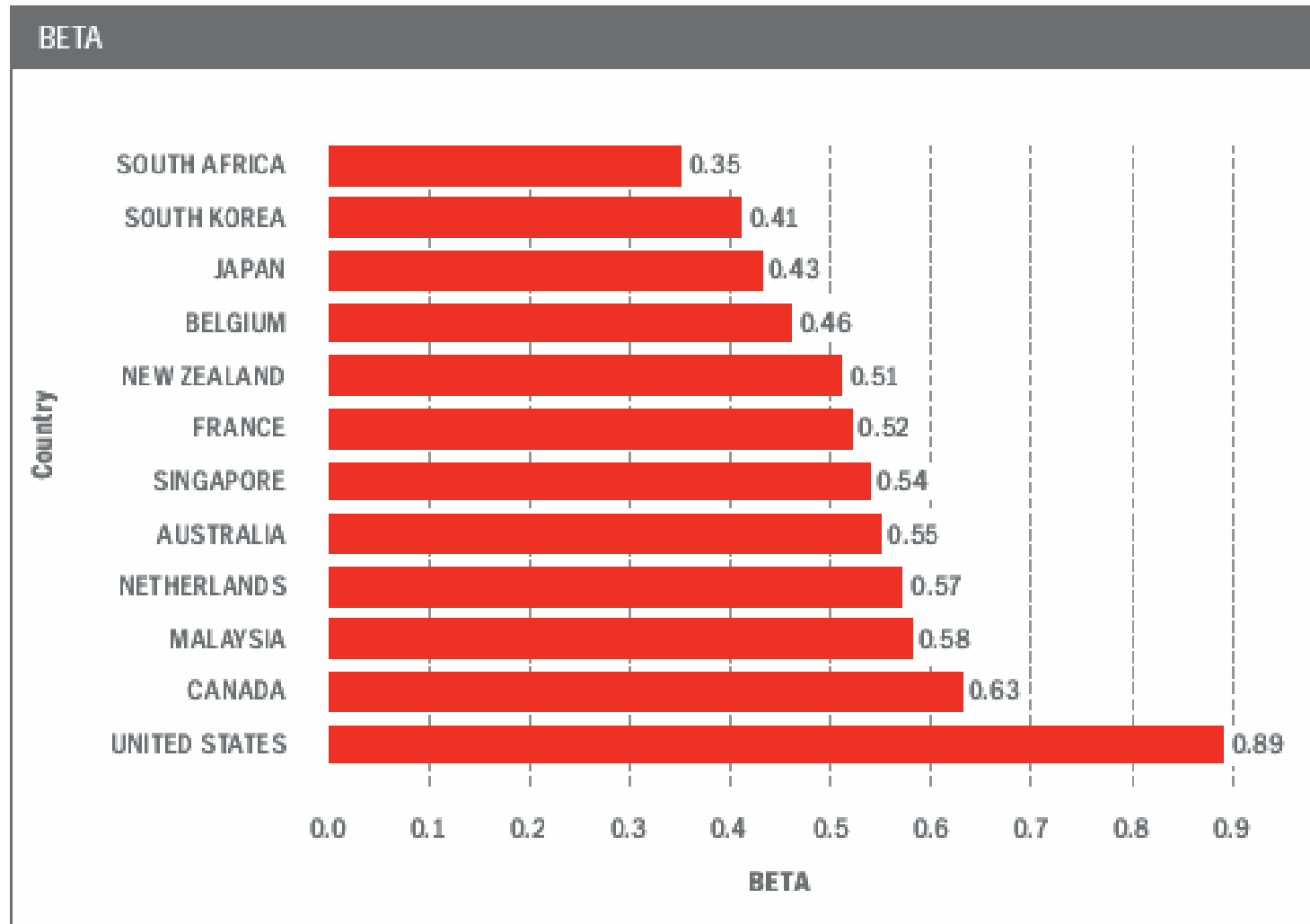
	FTSE NAREIT All REIT	FTSE NAREIT Equity REIT	S&P 500	Russell 2000	Nasdaq Composite ¹	Dow Jones Ind Avg ¹
2009	17.73	17.00	19.26	22.43	34.58	10.66
1-Year	-25.29	-28.40	-6.91	-9.55	1.46	-10.49
3-Year	-12.71	-12.39	-5.43	-4.57	-2.05	-5.96
5-Year	0.23	1.40	1.02	2.41	2.27	-0.74
10-Year	9.12	9.53	-0.15	4.88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

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

Measure of volatility



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

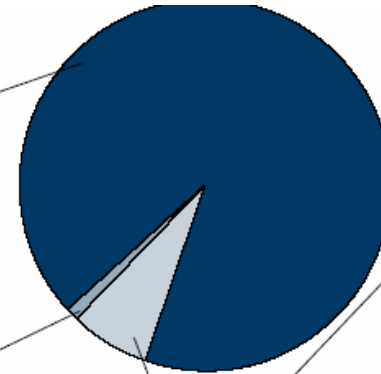


Types Of REITs

91% Equity REITs
Own Real Estate Assets;
Revenues Come Principally from Rents

1% Hybrid REITs
Combine the
Investment Strategies
of Equity and
Mortgage REITs

7% Mortgage REITs
Loan Money to Real
Estate Owners
or Invest in Existing
Mortgages or
Mortgage-Backed
Securities;
Revenues Come
Principally from
Interest on Mortgages

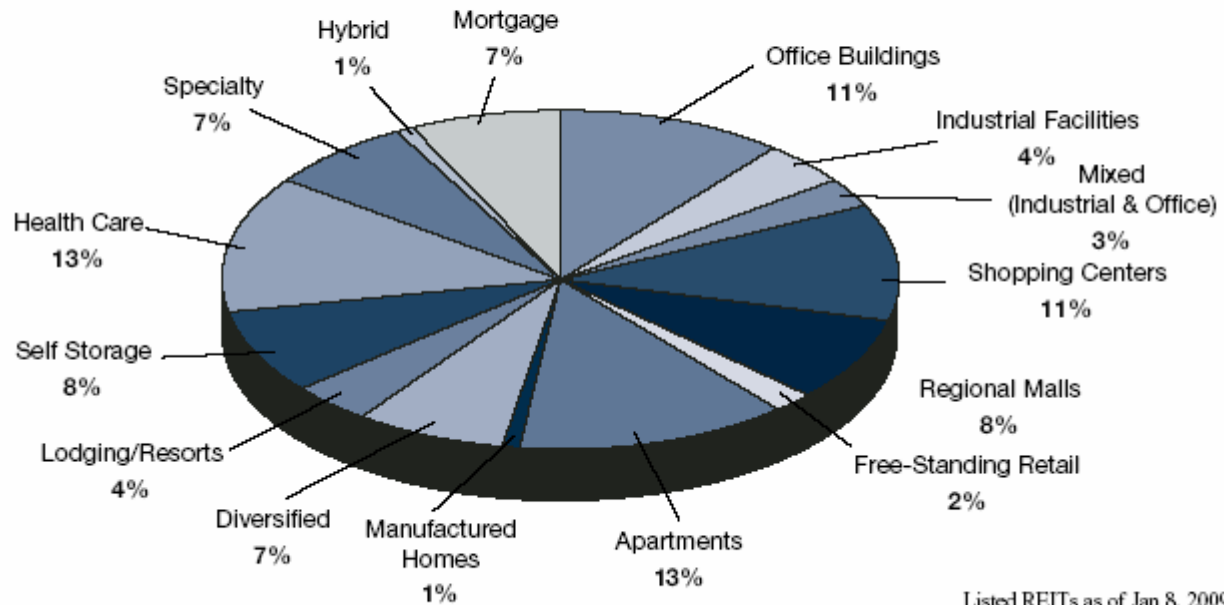


Listed REITs as of Jan 8, 2009
Source: NAREIT*

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Types of REITs – by property

Listed REITs Invest In All Property Types



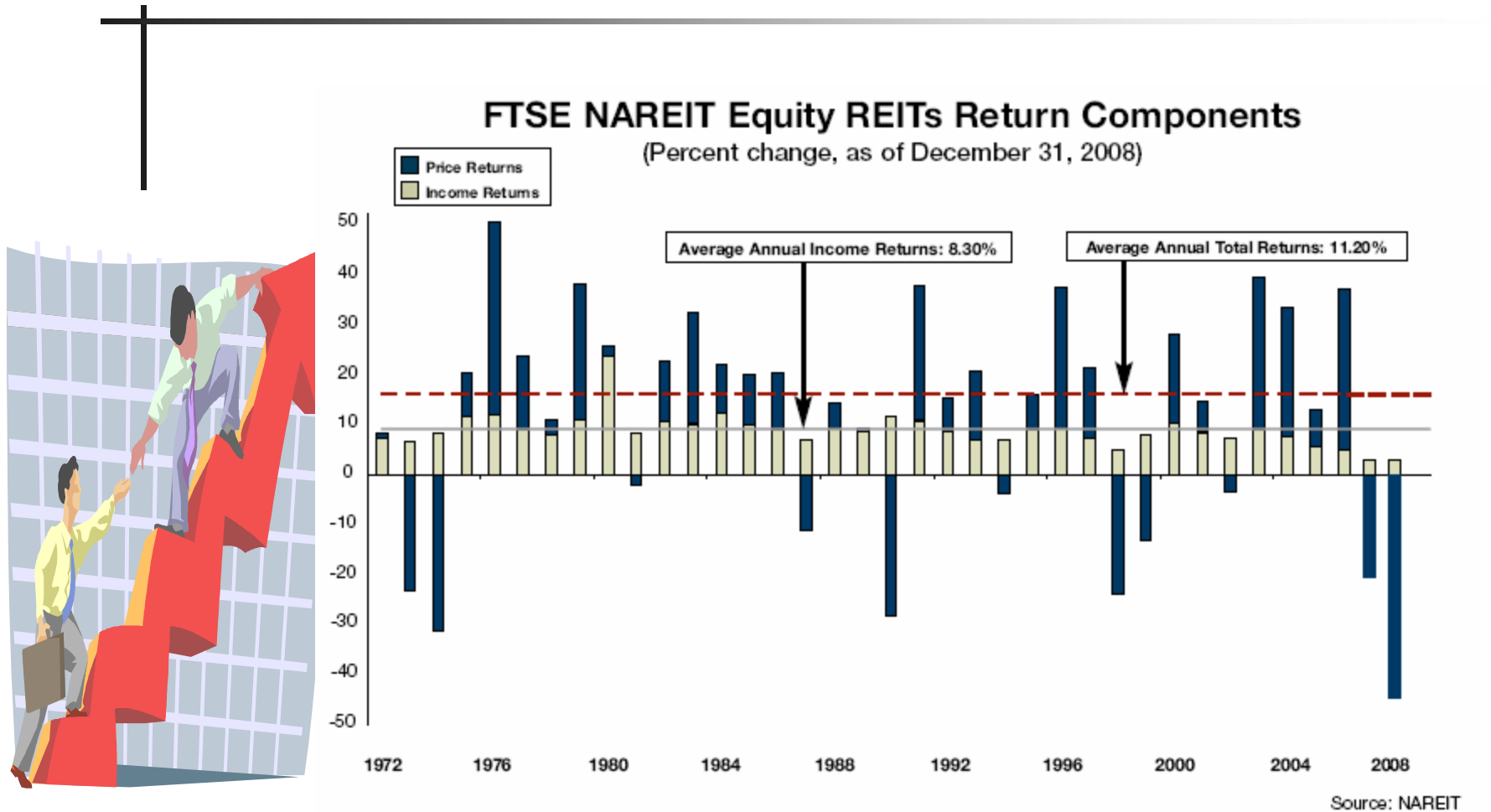
Listed REITs as of Jan 8, 2009
Source: NAREIT*

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

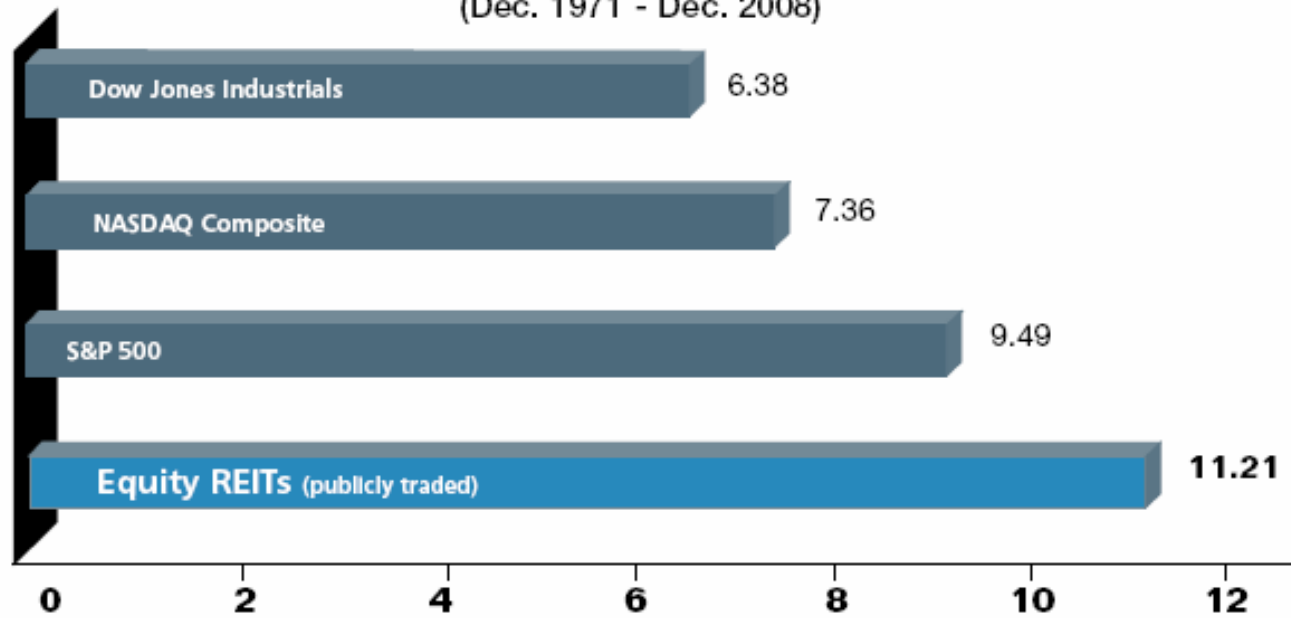


Performance of REITs



REITs Measure Up Over Time

Compound Annual Total Returns In Percent
(Dec. 1971 - Dec. 2008)



Source: NAREIT*

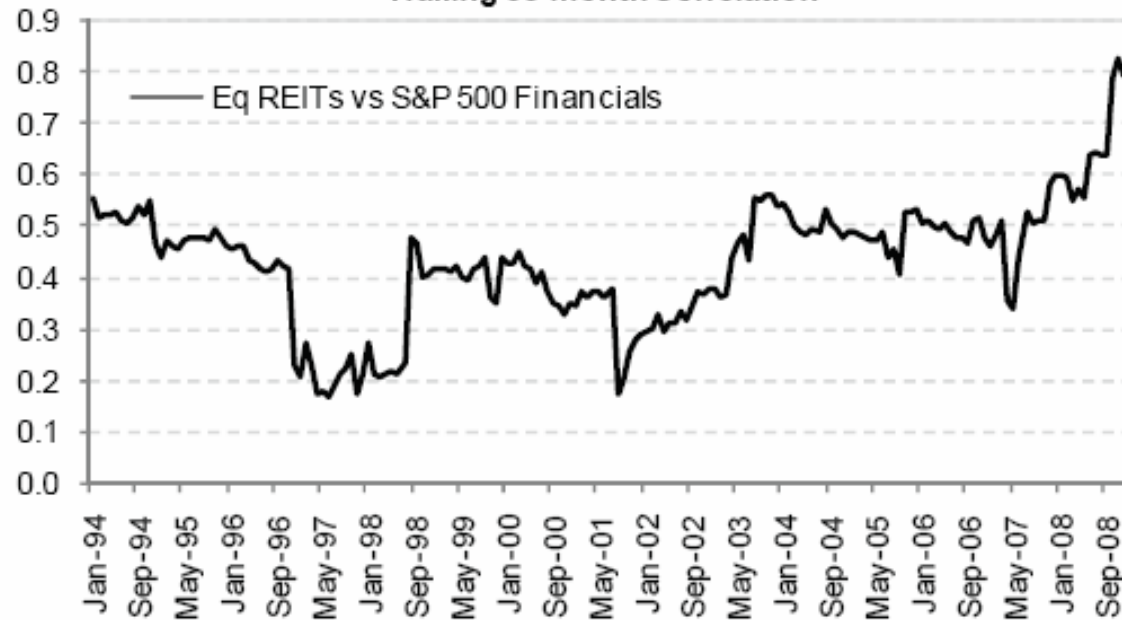
Past performance is no guarantee of future results.

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



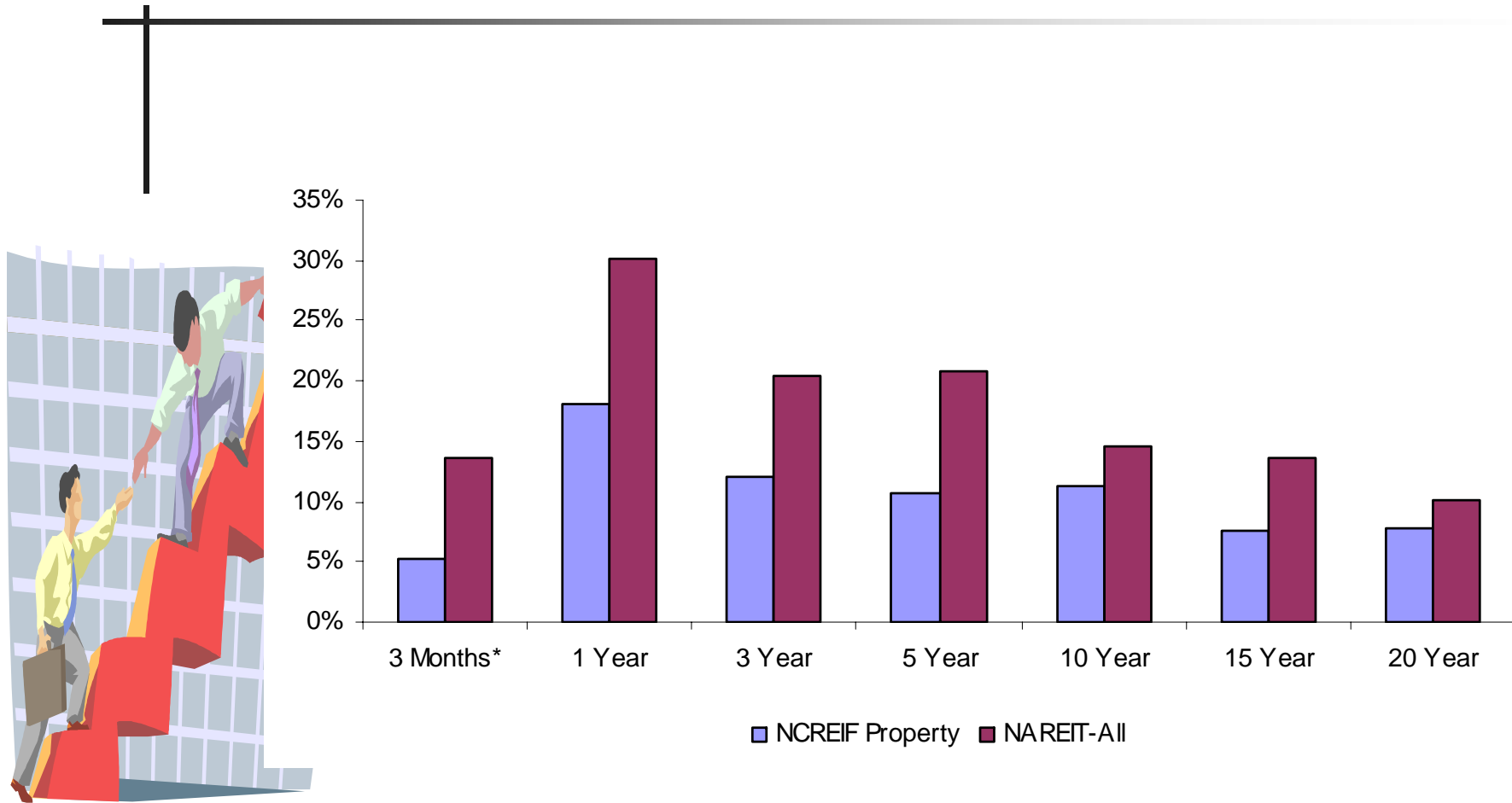
- General desire to have a portion of assets in real estate
 - Typically, 8 -10% real asset allocation
- A diversified investment in bricks
- Weaker correlation with financial securities
 - Asset price bubbles may be a cause for concern
- Dividends:
 - Reits distribute more regular income – why?
- Exchange-traded 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



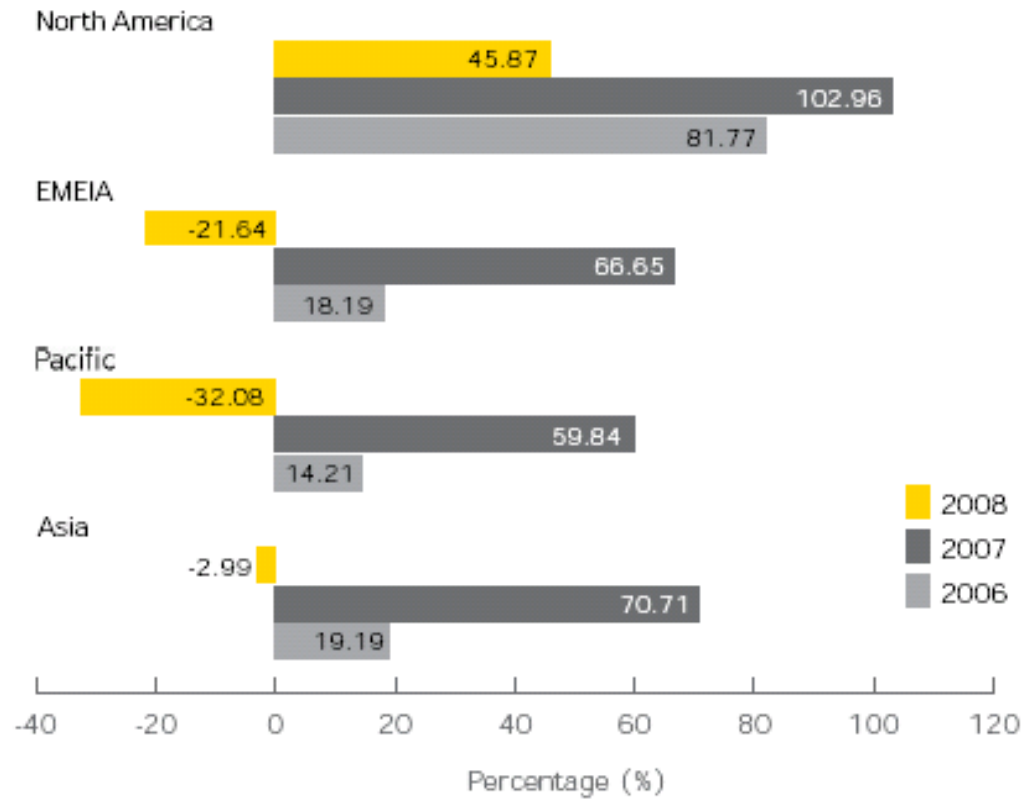
REIT returns (NAREIT index) versus private investment in property returns (NCREIF index)



NAVs and REIT values



Premium/discount of market price to net assets

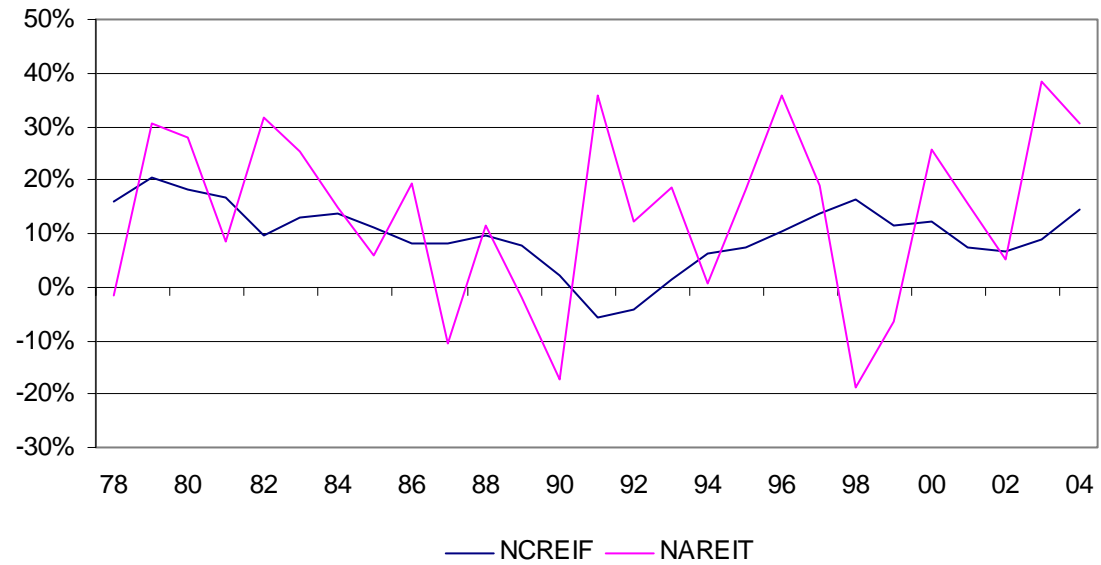


Source: E&Y 2008 REIT annual

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REITs versus NCREIF - volatility

REITs vs NCREIF returns



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



	US	Canada	UK	Netherlands	France	Japan	Australia
US	1.00	0.77	0.43	0.47	0.57	0.31	0.46
Canada	0.77	1.00	0.46	0.48	0.59	0.37	0.57
UK	0.43	0.46	1.00	0.65	0.67	0.31	0.48
Netherlands	0.47	0.48	0.65	1.00	0.82	0.37	0.56
France	0.57	0.59	0.67	0.82	1.00	0.32	0.49
Japan	0.31	0.37	0.31	0.37	0.32	1.00	0.23
Australia	0.46	0.57	0.48	0.56	0.49	0.23	1.00

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 5 can control 50% of the 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

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