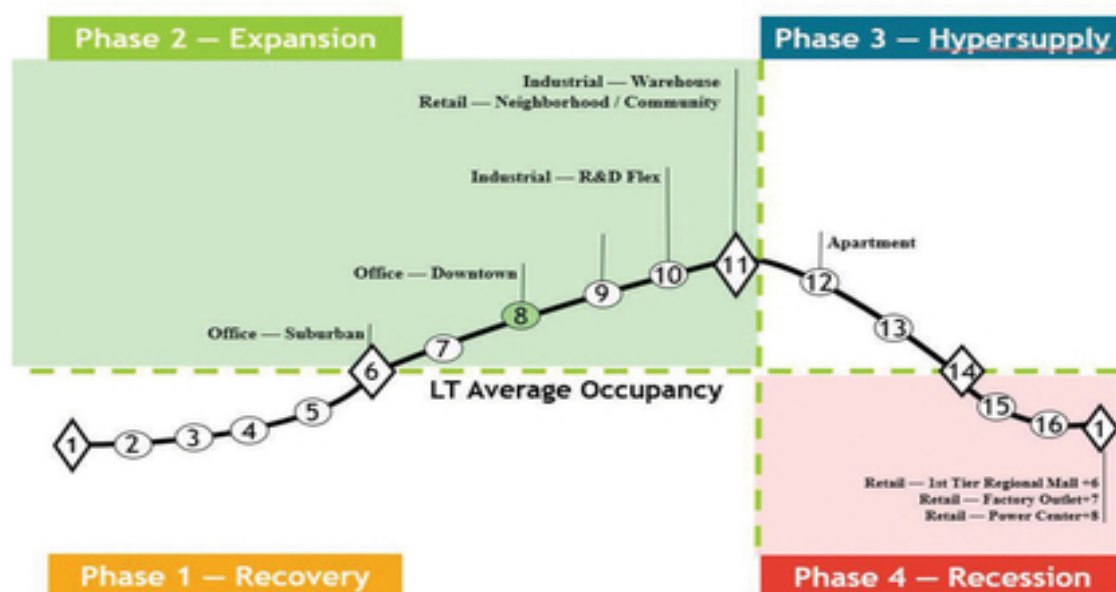


Educated REIT Investing

The Ultimate Guide to
Understanding and Investing in
Real Estate Investment Trusts

Stephanie Krewson-Kelly
Glenn R. Mueller

with Merrie S. Frankel and Calvin Schnure



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Stephanie Krewson-Kelly

Glenn R. Mueller, Ph.D.

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*To my son, William, and my husband, Matthew. Thank you
for indulging my passion for “The Three R's”: reading,
writing, and REITs!*

*To Jan for loving and living with your type A husband these
last 44 years.*

Foreword

Steven A. Wechsler
Nareit President & CEO

REITs were established by Congress in 1960 to make commercial real estate investment – once available only to the wealthy and large institutions – accessible to all investors. Today, more than 87 million Americans invest in REITs through their 401(k) or other retirement funds.

Even though REITs have grown to become an essential part of the investment universe with an equity market capitalization of approximately \$1 trillion, there is room for greater understanding of all that REITs have to offer. Enter *Educated REIT Investing*, which makes the REIT approach to real estate investment easily understandable to investors of all sizes and experience levels.

Stephanie Krewson-Kelly, Glenn Mueller, and their contributors have written a book that delivers a comprehensive window into REIT investment, sharing their insights on everything from how REITs are formed to the fundamentals of REIT stock analysis.

Educated REIT Investing explains the benefits of investing in REITs, including the important roles REIT stocks can play in addressing volatility and boosting the performance of investment portfolios. Importantly, the book also introduces readers to the broad spectrum of REIT market segments, explains their business models, and sheds light on their performance in various market conditions.

I have known Stephanie and Glenn for many years, and they are both well equipped to make the case for REITs and REIT investment. Stephanie brings her experience heading investor relations at Corporate Office Properties Trust, a

major NYSE-traded office REIT, coupled with her earlier roles as a well-regarded investment banker and REIT analyst.

Glenn is a longstanding member of Nareit's Real Estate Investment Advisory Council who has more than 40 years of real estate industry experience. He is internationally recognized for his Real Estate Market Cycle research and REIT research, his public and private market investment strategies, and his capital markets analysis.

I recommend this book to anyone looking to better understand REITs and real estate investment. Investors new to REITs can read it in its entirety and come away with a comprehensive introduction to REITs, while more experienced investors can also dive into the book for greater understanding of specific topics.

Preface

Many investors are unfamiliar with equity REITs – the world's largest real estate companies that own income producing properties, such as office, industrial warehouse, retail, apartment or hotel buildings – or with mortgage REITs, which invest in real estate-based (mortgage) loans.

The legislation that created the REIT structure was enacted by the US Congress in 1960 to allow small investors access to large multi-million-dollar and now even billion-dollar properties. In 2016, Standard & Poor's Dow Jones Indices (S&P) and MSCI Inc. (MSCI) created a new Global Industry Classification Standard (GICS) sector called *Real Estate*. Historically, REITs were classified in the Financials sector, but S&P and MSCI determined that real estate should be regarded as a distinct asset class – one that is different from banks and financial institutions. (Note mortgage REITs remained in S&P's *Financials* sector.) The Real Estate GICS sector elevated investor awareness of REITs, broadening their appeal to individuals and institutions.

Educated REIT Investing provides the essential information about REITs in an easy-to-understand format, using graphs, illustrations, and examples to make complex or unique concepts comprehensible. Even novice investors can gain a thorough understanding of the REIT market by reading the relevant industry background and simple examples presented in these pages. [Part I](#), An Introduction to REITs, presents basic information that will help investors quickly gain an understanding of what REITs are in order to have more informed conversations with their financial advisors. [Part II](#), Investing in REITs, is more technical in nature, with content geared for individuals who want to analyze and evaluate specific REITs before investing in them. The

content in *Educated REIT Investing* is distinctly different from other REIT books – and may still be read cover-to-cover in a day.

Here are a few industry background facts to get started:

- The REIT industry's aggregate equity market capitalization has increased exponentially from a mere \$8.7 billion at the beginning of 1990 to \$1.3 trillion at the end of 2019 (see [Table 1.1](#)).
- Innovations to the REIT structure that eliminated conflicts of interest between management and shareholders helped fuel the industry's growth. Equity REITs were added into the S&P 500 Index in 2001. Since then, REIT shares have attracted an increasingly broader array of investors, including general money managers, pension funds, hedge funds, and individual investors. As a result, the average monthly dollar trading volume for REITs increased from approximately \$350 million in 2000 to roughly \$8 billion in 2019, providing good liquidity for all investors.
- Along with higher trading volume, REIT stock price volatility also has increased dramatically. While the stock market is emotional in the short run, it is normally logical in the long run. Thus, greater volatility creates greater risk short term, but also greater potential returns long term. Applying good fundamental analysis is very valuable and should be rewarded.
- Despite REITs' historical long-term outperformance over other stocks, most investor portfolios are underallocated to real estate securities. Institutional Investor Allocations to real estate range from 5% to 20% with an average close to 10% – even though the Real Estate asset class is 20% of their investible universe. Also know that home ownership is *not* income

producing real estate; people live *in* their homes but must retire and live *on* their investments.

With REITs now in their 60th year and having grown rapidly over the past 30 years, it is surprising that basic information about REITs is not easy to find. Nareit[®] is a Washington, DC-based organization that represents and advocates for REITs globally. They provide a wealth of information on their website (www.reit.com) that is free, including the ability to receive daily emails and industry event information. They also show quarterly performance information with the Nareit T-Tracker, <https://www.reit.com/data-research/reit-market-data/nareit-t-tracker-quarterly-operating-performance-series>.

However, if investors don't know about Nareit and its online resources, information on individual REITs and the industry is difficult to obtain. If investors consult their financial advisors, they will still have incomplete information, as each brokerage firm typically has access only to information about the REITs actively covered by their research department. To remedy this information gap, the appendices of this book list the 219 REITs that comprise the FTSE Nareit All REITs Index at the end of 2019, as well as some basic information about each company. The following chapters present information in a progressive manner. Read as much or as little as you require, and welcome to the world of REITs.

Note: Unless noted otherwise, all prices, total returns, and data used in this book are as of December 31, 2019.

Acknowledgments

The following chapters reflect the experience and technical expertise of dozens of REIT industry professionals, whose contributions make this book a unique and invaluable resource for understanding and investing in real estate investment trusts.

Sincere thanks to the following individuals and organizations for their permission to reproduce select material and for the time they invested in editing this book's more technical content:

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- Green Street Advisors
- Michael Lewis, CFA, and Ki Bin Kim, CFA, at SunTrust Robinson Humphrey equity research

At the risk of omitting someone, we would like to thank numerous colleagues at Corporate Office Properties Trust (NYSE: OFC), especially Jack Lopez and Greg Thor for their technical edits to Chapters 8 and 11, respectively, and Michelle Layne, for her general edits to the entire manuscript and her mastery of PowerPoint. Sincere thanks also to the REIT equity research team at BTIG for their edits to [Chapter 6](#). Kudos to Will Azar, Denver University Graduate Assistant, for his edits as “fresh eyes” while learning about REITs for the first time.

Special thanks to David M. Fick, CPA, for providing technical edits and guidance on the evolution, benefits, and risks of operating partnership units ([Chapter 8](#)).

Thank you to our family and friends for their love, patience, and support during the months it took to compose this work.

Last but never least, sincere thanks to Nareit's Calvin Schnure ([Chapter 7](#)) and Merrie Frankel ([Chapter 9](#)), not only for contributing content, but also for their generosity in providing comments and advice on the entire manuscript. It has been an absolute pleasure working with you both.

About the Authors

Stephanie Krewson-Kelly's 26 years of experience in the REIT industry began in 1994 and includes work in investment banking (1994-97) and as an equity research analyst (1997-2009). Since 2011, Ms. Krewson-Kelly has served as vice president of investor relations at Corporate Office Properties Trust (NYSE: OFC), a publicly traded office REIT. Prior to her career in REITs, Ms. Krewson-Kelly worked as an internal auditor for a global corporation headquartered in Paris, France.

Ms. Krewson-Kelly is on the Board of Advisors at the University of Wisconsin's James A. Graaskamp Center for Real Estate (Applied REIT program) and teaches as an adjunct professor of real estate at Franklin L. Burns School of Real Estate & Construction Management at Denver University.

In between retiring from Wall Street and joining her current firm, Ms. Krewson-Kelly wrote *REIT Roadmap: An Insiders Guide to Successful Investing in Real Estate Investment Trusts* (second edition published in 2012 under her maiden name, Krewson; now out of print). In 2016, Ms. Krewson-Kelly wrote *The Intelligent REIT Investor: How to Build Wealth with Real Estate Investment Trusts* (Wiley, 2016).

In 1992, Ms. Krewson-Kelly graduated from the University of Pennsylvania's College of Arts & Sciences and Wharton School of Business, where she earned her respective B.A. in English and B.S. in Economics.

Glenn R. Mueller, Ph.D. has 44 years of real estate industry experience, including 37 years of research. Mueller is internationally known for his market cycle

research on income producing real estate, his real estate securities (REITs) research, and his public and private market investment strategies and capital markets analysis. Glenn is a professor at the University of Denver's F.L. Burns School of Real Estate & Construction Management, teaching and doing research in development, feasibility, investments, and real estate capital markets. DU's program started in 1938 and offers undergraduate (BS) and graduate (MS, MBA, & PhD) degrees in business RE&CM. He has published 100+ research articles and 110+ quarterly issues of his Real Estate Market Cycle Reports. He held research positions at Legg Mason Inc., PriceWaterhouseCoopers, ABKB/ Jones Lange LaSalle Real Estate Investors, and Prudential Real Estate Investors.

He is also the Real Estate Investment Strategist at Black Creek Group, Advisory board member at Arden Group, former chairman of the board for European Investor's REIT fund, and a 20-year visiting professor at Harvard. He holds a B.S.B.A. from University of Denver, M.B.A. from Babson College, and Ph.D. in Real Estate from Georgia State University.

PART I

AN INTRODUCTION TO

REITs

Part I of this book begins with very basic information that will be helpful to individuals who have little or no prior knowledge of REITs. [Chapter 1](#) addresses industry size, the different ways REITs are classified, and online resources for learning more about the industry and individual companies. [Chapter 2](#) provides an overview of the benefits of investing in REITs, followed by a discussion of real estate fundamentals in [Chapter 3](#). [Chapter 4](#) discusses REIT dividends in great detail, including how to calculate the current yield and the yield on cost, ways to quickly assess if a dividend is safe, and how dividends generally are taxed at the investor level. [Chapter 5](#) provides an overview of different lease structures associated with various property types that REITs own, followed by a discussion in [Chapter 6](#) of the property sectors and subsectors REITs own and that Nareit® tracks. [Chapter 7](#) discusses mortgage REITs in detail.

These first seven chapters are designed to provide foundational information about real estate as an investment asset, REITs that own different types of real estate, and REIT dividends. The chapters that compose Part II of the book build upon this fundamental knowledge and address the more technical aspects of analyzing and investing in the common shares and fixed income securities that REITs issue.

CHAPTER 1

What Is a REIT?

A real estate investment trust (REIT, pronounced “reet”) is an entity that receives revenue through owning or financing income-producing property. Similar to other industries, REITs can be private organizations, public but non-traded, or they can be publicly traded on a stock exchange. ([Chapter 8](#) compares the benefits of publicly traded REITs versus private and public non-traded REITs.) By being publicly traded, REITs are similar to mutual funds that are accessible to all investors, who can benefit from receiving real estate income without purchasing, managing, or financing property directly.

Publicly traded REITs are bought and sold like the stock of any other public company. Unique to REITs, however, is their tax status. The *Real Estate Investment Trust Act of 1960* legislation that created the REIT structure exempts companies that qualify as REITs from paying corporate income tax (just like mutual funds), provided they distribute their taxable income as dividends. To qualify as a REIT in the eyes of the Internal Revenue Service (IRS), a company must meet many specific criteria. The most widely known provision is that a REIT must pay shareholders a dividend equal to at least 90% of what would otherwise be taxed as ordinary income. ([Chapter 8](#) highlights the fundamental technical hurdles companies must clear to qualify for REIT tax status.)

Nareit® (formerly known as the National Association of Real Estate Investment Trusts) is the worldwide representative voice for REITs and publicly traded and non-traded real estate companies with an interest in US real estate and capital markets. Nareit's website, www.reit.com, provides investors with educational resources, research, and data and index information, as well as news and information about [the](#) industry.

SIZE OF THE REIT INDUSTRY

As of December 31, 2019, Nareit tracked information on 226 publicly traded REITs with a combined public equity market capitalization (or size) of \$1.3 trillion. [Table 1.1](#) presents year-end data on the REIT industry's capitalization going back to 1971. The market capitalization shown excludes operating partnership (OP) units, which are similar to shares of common stock in the REIT, but which are not publicly traded. (OP units are discussed in detail in [Chapter 8](#).) The FTSE Nareit All REITs Index includes 219 of the total 226 REITs tracked; 184 REITs were listed on the New York Stock Exchange (NYSE) and the remaining 35 were listed on either the National Association of Securities Dealers Automated Quotation System (NASDAQ) or the NYSE American (NYSE MKT, and formerly known as the American Stock Exchange [AMEX]). Before delving into the benefits of investing in REITs, investors will find it instructive to understand a few more basics about how these companies are categorized and where information on each can be found.

CATEGORIES OF REITS

The two broadest categories for REITs – equity and mortgage – are based on the types of investments they make and the nature of their revenues. Equity REITs were included in S&P's *Real Estate* Global Industry Classifications Standard (GICS®) Sector Index when it was created in 2016; mortgage REITs (mREITs) remained in the *Financials* sector. REITs are also classified by the type of property they own, such as office or apartment buildings, and by other means discussed in the following pages. Before buying or selling any stock, investors should know whether the REIT is an equity REIT or a mortgage REIT, and what type(s) of property it owns. Nareit tracks equity REITs according to property type and

mortgage REITs according to whether their investments are backed by residential or commercial real estate. [Chapters 6](#) and [7](#) provide additional information to help investors identify REITs that fit their portfolio objectives.

Equity REITs

Equity REITs derive the majority of their revenue from rents paid by tenants according to the terms of leases that exist between the REIT (the landlord or lessor) and its tenants (the lessees). These REITs usually have *fee simple interest* in their properties and use debt to finance a percentage of the purchase price. This investment approach is similar to how individuals purchase homes in that the REIT generally uses some amount of debt and pays the remainder in cash (equity). Fee simple interest in real estate means the buyer receives title to the land and improvements, which include the building and any structures that exist on the land. The debt a REIT uses to finance a portion of a property ranges from a simple mortgage (which is also called *property-level* debt) to publicly traded, corporate-level bonds (also called *senior* or *unsecured* debt). [Chapter 9](#) discusses real estate fixed income securities in greater detail.

TABLE 1.1 Historical REIT Industry Market Capitalization and Total Returns*

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	All REITs				All Equity REITs				All Mortgage REITs		
Year Ended	# of REITs	EMC ^a (\$MMs)	Total Return ^b		# of REITs	EMC ^a (\$MMs)	Total Return ^b		# of REITs	EMC ^a (\$MMs)	Total Return ^b
1971	34	\$1,494	—		12	\$332	—		12	\$571	—
1972	46	\$1,881	11.2%		17	\$377	8.0%		18	\$775	12.2
1973	53	\$1,394	−27.2%		20	\$336	−15.5%		22	\$517	−36
1974	53	\$712	−42.2%		19	\$242	−21.4%		22	\$239	−45
1975	46	\$900	36.3%		12	\$276	19.3%		22	\$312	40.8
1976	62	\$1,308	49.0%		27	\$410	47.6%		22	\$416	51.7
1977	69	\$1,528	19.1%		32	\$538	22.4%		19	\$398	17.8
1978	71	\$1,412	−1.6%		33	\$576	10.3%		19	\$340	−10
1979	71	\$1,754	30.5%		32	\$744	35.9%		19	\$377	16.6
1980	75	\$2,299	28.0%		35	\$942	24.4%		21	\$510	16.8
1981	76	\$2,439	8.6%		36	\$978	6.0%		21	\$541	7.1
1982	66	\$3,299	31.6%		30	\$1,071	21.6%		20	\$1,133	48.6
1983	59	\$4,257	25.5%		26	\$1,469	30.6%		19	\$1,460	16.9
1984	59	\$5,085	14.8%		25	\$1,795	20.9%		20	\$1,801	7.3
1985	82	\$7,674	5.9%		37	\$3,270	19.1%		32	\$3,162	−5.2
1986	96	\$9,924	19.2%		45	\$4,336	19.2%		35	\$3,626	19.2
1987	110	\$9,702	−10.7%		53	\$4,759	−3.6%		38	\$3,161	−15
1988	117	\$11,435	11.4%		56	\$6,142	13.5%		40	\$3,621	7.3
1989	120	\$11,662	−1.8%		56	\$6,770	8.8%		43	\$3,536	−15
1990	119	\$8,737	−17.4%		58	\$5,552	−15.4%		43	\$2,549	−18
1991	138	\$12,968	35.7%		86	\$8,786	35.7%		28	\$2,586	31.8
1992	142	\$15,912	12.2%		89	\$11,171	14.6%		30	\$2,773	1.9
1993	189	\$32,159	18.6%		135	\$26,082	19.7%		32	\$3,399	14.6
1994	226	\$44,306	0.8%		175	\$38,812	3.2%		29	\$2,503	−24
1995	219	\$57,541	18.3%		178	\$49,913	15.3%		24	\$3,395	63.4
1996	199	\$88,776	35.8%		166	\$78,302	35.3%		20	\$4,779	50.9
1997	211	\$140,534	18.9%		176	\$127,825	20.3%		26	\$7,370	3.8
1998	210	\$138,301	−18.8%		173	\$126,905	−17.5%		28	\$6,481	−29
1999	203	\$124,262	−6.5%		167	\$118,233	−4.6%		26	\$4,442	−33
2000	189	\$138,715	25.9%		158	\$134,431	26.4%		22	\$1,632	16.0
2001	182	\$154,899	15.5%		151	\$147,092	13.9%		22	\$3,991	77.3
2002	176	\$161,937	5.2%		149	\$151,272	3.8%		20	\$7,146	31.1
2003	171	\$224,212	38.5%		144	\$204,800	37.1%		20	\$14,187	57.4
2004	193	\$307,895	30.4%		153	\$275,291	31.6%		33	\$25,964	18.4
2005	197	\$330,691	8.3%		152	\$301,491	12.2%		37	\$23,394	−23
2006	183	\$438,071	34.4%		138	\$400,741	35.1%		38	\$29,195	19.3