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REITs

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Invest in institutional-quality real estate easily

Understand how to evaluate, analyze, and profit from REITs

Build a lasting income portfolio and sleep well at night

Brad Thomas

#1 Analyst on REITs and Finance

REITs

By Brad Thomas

for dummies
A Wiley Brand

REITs For Dummies®

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Contents at a Glance

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Introduction

It never occurred to me back in college that I should become a virtual landlord — which is what owning shares of real estate investment trusts, or REITs (pronounced "reets"), entails. It never occurred to me after graduation when I was working my first job, either. In fact, it didn't occur to me for the first two decades of my professional experience.

It's not that I had anything against being a landlord. Quite the opposite, actually. I wanted to become rich by owning real estate since I was about ten years old. Truly. And most of my adult life was spent developing commercial real estate — hands-on and from the ground up. I also studied many of the well-known *Forbes*-list billionaires with that goal in mind. This included Donald Bren (founder of Irvine Company), Stephen M. Ross (founder of Related Companies), Leonard Stern (founder of Hartz Mountain), and Sam Zell (founder of Equity Group Investments). That latter individual happened to be a REIT chairman — three times over! And all of them built their considerable fortunes on real estate. They directly owned and rented properties out, collecting that income and watching their bank accounts soar as a result.

That makes it sound easy-peasy, I know, so let me start out with a very firm clarification. I can attest from personal experience (in real estate construction and management, not in being a billionaire) that it takes a lot of blood, sweat, and tears to generate that kind of wealth. The individuals just mentioned took on considerable work and risk in order to achieve their success stories. There's a reason why only 1.1 percent of people in the world are millionaires, much less anything higher.

With that said, there's a way to generate significant wealth in real estate by becoming a virtual landlord. It might not make you a billionaire (unless you have a lot of money to start out with), but it also comes with almost no blood, sweat, or tears.

About This Book

That's what *REITs For Dummies* is all about — helping you safely create generational wealth and sustainable cash flow by investing in companies that invest in commercial real estate. I'm extremely honored to write it since I know the positive impact it can have on millions of readers around the globe. My more than three decades of experience as a real estate developer, investor, and analyst provides me with a unique perspective about REITs that I'm more than happy to pass on to you.

Some of that experience was extremely rough — even traumatic. Back before I realized the power and long-term profit potential of REITs, I made a lot of mistakes. I built up a fortune that was ultimately unsustainable: a house of cards that the 2008 crisis toppled in an astonishingly short amount of time. I had to build myself back up from that; it was a journey I now recognize as an immense blessing in disguise. It taught me so many invaluable lessons that not only benefit my life but my readers' and followers' lives as well.

That's why *REITs For Dummies* covers as much as it does, from how these assets got started to how they operate to how to analyze them to how to include them in your portfolio.

I don't for one second or sentence advocate REITs as a perfect investment. You'll see me repeat that caution over and over again throughout the following pages. For that matter, anyone who touts anything as a perfect investment is either grossly misinformed or trying to take your money without making you any in return. But REITs do offer benefits that other assets simply don't and can't. This means they can complement your larger investment portfolio in unique ways that promote both wealth creation and wealth preservation.

Foolish Assumptions

I have a very well-established REIT–analyzing presence through platforms such as Seeking Alpha (a site that allows individual experts to distribute their investment findings) and Wide Moat Research (a company that publishes both free and paid articles on dividend-paying opportunities). Through those, various investment conferences, and personal interactions, I'm used to discussing REITs with a wide range of people, from those who've never heard of them all the way to industry experts and insiders.

I understand that everyone comes to the table with varying amounts of information and finances to work with — not to mention different goals, personalities, and tolerance levels. With that said, I did write this book for a specific set of people. It's a pretty broad set, mind you, but I'm still assuming that if you want to read *REITs For Dummies*

- You know the basics of investing, such as what a dividend-payer is.
- You've got enough money to invest without having to take a loan out, destroy your emergency fund, or sell a kidney on the black market.
- You already have an investment portfolio of some kind, just one that doesn't feature REITs or doesn't feature enough of them.

Admittedly, that last assumption isn't going to ruin this read for you if it doesn't apply. I would just suggest that you perhaps start with something like *Investing All-In-One For Dummies* by Eric Tyson (Wiley). Then come back to this after you're done.

Icons Used in This Book

Speaking of such, the *For Dummies* brand of books aren't actually made for dummies. They're made for intelligent people who recognize a lack of knowledge in some area they'd like some knowledge about. Moreover, they're made for intelligent people on the go. (However, you can still easily benefit from them if you're retired with nothing but sweet, sweet time on your hands.) That's why each one includes a list of icons to help you digest the information at hand in a way that best benefits you and your schedule. This REITs addition to the *For Dummies* universe is no different. Here are the icons you'll encounter and a brief description of each:

TIP

Whenever you see this symbol, it signifies some way to make your life easier. This might be with additional information or an insight into how to implement previous information as best as possible.

REMEMBER

Let me be blunt: There is some information in this book that you don't necessarily need to know, depending on exactly what you're looking for (more about that in a minute). The sidebars — those shaded boxes — for example, can be considered extra-curricular reading or fun additional facts. However, when you see the Remember icon, it's something you want to zero in on and commit to memory.

TECHNICAL STUFF

This one's pretty obvious but let me explain it all the same. The Technical Stuff icon marks information of a highly technical nature that you can skip over if you don't want to get into the weeds.

WARNING

As I've already stated and will state again, there is no such thing as a perfect investment. But you can make REITs a lot closer to that ideal by avoiding dangers such as the ones highlighted by the Warning icon.

PROPTECH

The appeal and importance of real estate doesn't change, but the way we interact with that real estate certainly has over the millennia — an evolution that's sped up immensely in recent decades. That's why I make sure to highlight facts and figures that show the ever-increasing blend between property ownership and technology.

Beyond This Book

If you still want more after you're done reading everything I've got here, don't worry. I've got your back with a bit more information over at `www.dummies.com`, where I've added a few more pages of details you might want to know. Search for "REITs For Dummies Cheat Sheet" in your favorite search engine.

Where to Go From Here

Since you've made it this far, I'm guessing (another assumption, I know) that you're ready to read further. In which case, have at it!

Naturally, I think everything in the following pages is worth reading. (It's an amazing body of work and so well-written, didn't you know?) But feel free to disagree. I imagine you have a better idea of what you're looking for than I do. So if you saw chapter headings in the table of contents that zero in on your particular needs, jump right to them. There's no standing on ceremony here.

Each chapter is largely meant to stand out by itself and for itself. This allows you to save some time and skip over sections you already know or that don't pertain to you. However you choose to read the book, I hope you find both happy reading . . .

. . . and happy REITing!

1

Getting Started with REITs

IN THIS PART . . .

Find out what REITs are, what they do, and how they raise money.

Explore the sheer size of the publicly traded U.S. REIT sector.

See why real estate is a dependable asset to have in your portfolio.

Understand the differences between REITs, business development companies (BDCs), and master limited partnerships (MLPs).

Get the scoop on the forgotten side of REITs: Private and public non-listed possibilities.

Look at the pros and cons and ins and outs of international investing.

IN THIS CHAPTER

- » **Discovering what REITs are and what they do**
- » **Recognizing the sheer size of the publicly traded U.S. REIT sector**
- » **Checking out REITs on the street**
- » **Finding out why REITs are easy to love**

Chapter 1
Who Wants to Be a Virtual Landlord?

Being a landlord can make you rich. That's what you want to hear, I know. And fortunately, it's true. Owning buildings and renting them out can be extremely rewarding as you collect income from the property you own. All the same, I wouldn't call being a landlord an easy road to wealth.

There's a lot involved in renting out property on a legal level and perhaps even more so on an ethical one. So many issues can (and do) come up, from structural considerations regarding the actual buildings and properties they sit on to weather-related hazards that can literally hit your holdings, to general nuisances and differences of opinion with tenants. For those who manage entire apartment buildings, those differences can present themselves on a daily basis.

But suppose you could bypass all that by being a virtual owner instead. Suppose you could be almost entirely oblivious of the day-to-day details of dealing with rentals and renters — yet still receive steady income from them every month or every quarter. Suppose you could go online, click a few buttons, and put a few hundred dollars down (or more, if you so choose) to become an almost instant virtual owner of commercial real estate.

Would you be interested? If so, this book about real estate investment trusts, or REITs, is for you.

Commercial Real Estate for the Masses

For centuries and even millennia, owning property was a wealthy person's venture. In fact, land was one of the biggest signifiers of wealth, with kings and lords fighting wars over who was entitled to what. Peasants and even noblemen stayed on land at the will of their superiors. And while that arrangement wasn't always the brutal, one-sided affair Hollywood likes to portray, it obviously was a far cry from an easy road toward wealth independence.

Even as global societies advanced and individuals started owning their own homes, commercial real estate and its benefits (potential pitfalls as well) remained firmly a resource for the rich. It wasn't until the mid-20th century that REITs (pronounced "reets") were introduced and we "little people" had a solid chance of benefiting from sizable property ownership, too. This game-changing category gives the average investor the same access to property-based money-making potential as the rich. I'd even go so far as to say that REITs exist to even out the playing field. (For more detail on when and where and how they were created, turn to Chapter 3.)

REMEMBER

REITs are companies that own, manage, and/or finance real estate holdings. These holdings can be in the form of apartment buildings, hotels, shopping centers, self-storage facilities, warehouses, and even billboards, data centers, and woodlands. And that's the short list — a list that keeps growing every decade. In Chapters 6 and 7, I go through each REIT sector in detail, discussing their pros and cons, because there are definite positives and negatives to know about.

TIP

As I continuously stress throughout this book, there is no such thing as a perfect investment. So the more you know about REITs — or any other asset you want to put money into — the better off you'll be.

REITs Do the Work for You

You probably don't have the finances, time, or desire to start your own real estate investment trust. Which is perfectly fine. Even reasonable. But if you're reading this book, you probably do have the finances, time, and desire to buy into REITs that someone else started, developed, and continues to successfully run.

As I previously state, it takes very little money, comparatively speaking, to buy a few shares. And when it comes to publicly traded REITs — the ones you see listed on the stock market — it takes just a call to your broker or a series of clicks on your keyboard to get the deal done. That's all you need to become a landlord.

And not just any landlord, but a no-muss, no-fuss one. Because, again, you're a shareholder owner, not a hands-on owner. That means you don't have to deal with collecting rent, fixing roof leaks, paying insurance, or evicting problematic tenants and finding better ones.

Take it from me. I have more than three decades of experience in building and brokering over $1 billion of income-producing real estate transactions. I've been a landlord to drugstores, auto parts stores, casual-dining restaurants, fast-food restaurants, tire centers, grocery stores, movie theaters, bookstores, discount stores, warehouses, billboards, cell towers, office buildings, and fitness centers. So trust me when I say there's a lot involved.

Regular landlords have to deal with things like high leverage, partnership disputes, recessions, tenant bankruptcies, and even tornadoes. (My neck of the woods in South Carolina isn't part of Tornado Alley by most definitions, but we still get these forces of nature more often than I'd like.) In Chapter 3, I explain the three Ts most landlords wish they didn't have to deal with: toilets, trash, and taxes. By this, I mean all the parts and pieces they're responsible for — the physical structures complete with pipes, electrical wiring, windows, and doors — as well as services and those pesky obligations to Uncle Sam.

This all adds up, taking significant chunks out of the money landlords make.

REMEMBER

Of course in a capitalistic society, they're not supposed to add up more than your profits. If you do it right (with perhaps a little bit of luck added in), you can make a really decent living. There are specific advantages to owning direct real estate, such as depreciation and lower volatility, as I explain in Chapter 2. But doing it right entails a lot of time, effort, and financing.

There's also the fact that even if you were making a seven-figure salary, it would still be difficult to personally buy up such properties as

- Caesars Palace in Las Vegas
- The Empire State Building in New York City
- The Hilton Waikoloa in Hawaii

The same goes for 195,000 acres of farmland, 226,000 cellphone towers, or over 12,000 free-standing properties worldwide — each set with a single purchase. And that's to say nothing about strings of properties in more than 40 countries and regions around the globe.

Yet REITs allow you to do exactly that. You don't get to own the entirety of those portfolios, of course. You're just one of hundreds, thousands, or even tens of thousands of other investors. But as I note in Chapter 3, fractional ownership still matters. Plus, you still get a piece of the rental profits, not just through share price appreciation but also through dividend payments multiple times per year.

This is because REITs, by law, have to pay out at least 90 percent of their taxable income to their shareholders in the form of dividends. As Chapter 3 details, this allows them to avoid taxes themselves. Shareholders still have to pay taxes on any gains you make, mind you. But they get higher dividends as a result of this corporate-level deal.

Get Paid While You Sleep

One of the reasons I decided to get into the real estate rental industry (so many moons ago) was because someone told me the best way to make money is while you're sleeping. It sounded like good advice, and I took it to heart along the way.

Being a landlord certainly helped me generate significant wealth by leveraging the most powerful tools of appreciation and compounding, as I discuss in Chapter 2. What I didn't know at the time though was that REITs provide all those benefits, plus the benefit of liquidity, along with transparency and diversification.

This is what makes so many REITs *sleep well at night,* or SWAN, investments. While I didn't coin the term, I use it to describe a high-quality stock that pays out dividends while you're sleeping . . . like so many of the REITs I explore in this book.

Size Does Matter

Here's another factor to appreciate about these commercial real estate assets: their sheer size. This is a big deal for a number of reasons. For one thing, the publicly traded U.S. REIT sectors magnitude makes it liquid, allowing investors to trade in and out largely at will. Another point to consider is how the wide, wide world of real estate investment trusts provides investors with considerable diversification benefits.

For instance, tech-centered investors who want something more affordable and less volatile than Facebook can look to Digital Realty, a massive (and growing) network of data centers around the world. Or if you think that brick-and-mortar retail isn't going away, you can consider my favorite REIT, Realty Income. This means that you (the investor) can design and build your portfolio based on your individual tastes and preferences. In Chapter 10, I provide a blueprint to consider strategies I've used over the years.

There are also basic REIT categories to consider above and beyond which properties they tend to buy, which means the larger asset class provides even more opportunity to diversify. I break them all down in Chapter 4 if you want to see what I mean.

Basically, commercial real estate in general and REITs in particular are enormous investment categories that offer something for just about every investor, no matter what their interests and goals are.

Focusing on Fundamentals

I'm sure you're familiar with the board game Monopoly, where you use play money to buy real estate, utilities, and railways. The goal is to dominate the board and have scale advantage — the point where a company has a big enough presence that it gets better banking and business deals than the competition. The issue is how to go about it. Which properties should be picked up and which ones should be passed over?

The same questions apply to income-producing real estate in the real world. When you invest in it by buying up REIT shares, you're buying (portions of) portfolios in high-quality, well-placed real estate operated by professional, ethical management teams. That's the ideal, anyway, and the ideal is very often true. But it's not a guarantee, so you do have to research and analyze what you find.

At least you really, really should.

If that sounds daunting, don't worry! That's what Chapter 8 is there for — my favorite chapter in this book. It's where I show you how to choose your REITs wisely by understanding how to calculate property values and earnings metrics, as well as balance sheet basics. The key to unlocking their value is rooted in their cost of capital: how much money they're spending in order to make money.

REMEMBER

You need to know that REITs thrive when their return on invested capital (ROIC) is greater than their opportunity cost of capital. If the former is at or below the latter, growth may not create value and can lead to a *value trap* or *sucker yield* scenario. More about those in my favorite chapter.

TIP

I also use Chapter 8 to fill you in on REIT–specific financial terms such as funds from operations (FFO) and net asset value (NAV). These can help you understand the margin of safety concept further as you start analyzing potential portfolio picks for yourself. In which case, always keep in mind that the subjects of risk and cost of capital are essential and inseparable. So while you're free to read this book in whatever order you'd like, picking and choosing topics as you see fit, I recommend that you not skip over Chapter 8. It's got way too much important information in it.

REITs on the Street

If you've read this far, feel free to stop for a little bit. I've got some homework for you.

Get out of the house. Go for a drive. See what you can see. Or, if you're perfectly content reading on right away, at least think about your daily commute to work, the grocery store, church, the gym, or wherever else you tend to go. No matter where you're headed locally (in the United States, at least), there's a good chance you'll find yourself in close proximity to a REIT–owned property. That workplace, grocery store, church (yup, even some churches), or gym you frequent might even fall under that category.

As I reference in Chapter 4, REITs own approximately one out of every ten institutional-quality buildings in the United States. And that percentage continues to grow with investor demand.

A Slice for All Types

While REITs were designed for the average investor, I explain in Chapter 11 that institutions, such as pensions and endowments, buy them up too. These are the big fish. The whales. And boy, but do they like to eat up shares of whatever they fix their appetite on, including REITs.

TIP

Don't be hating on these big-time players, though. They're not stealing from your pool of potential. If anything, they're helping your investments grow both in recognition and price. This category of investors is important to the growth of the sector in ways that I'm more than happy to lay out.

There are now 29 REITs included in the S&P 500 (as of May 2023). That could not have occurred without enormous firms like Vanguard, Cohen & Steers, Green Street, BlackRock, and State Street getting involved. For decades, that wasn't the case, which was to REITs' detriment. Institutional investors chose to allocate funds elsewhere, deeming REITs to be too new and risky. And I'm not saying they were wrong in displaying caution.

But REITs evolved into something worth putting big money into. I detail their historical progression in Chapter 3, including how 150 million Americans now live in households that invest in REITs through their 401(k)s, IRAs, pension plans, and other investment funds. You can also own REITs through vehicles such as exchange-traded funds (ETFs), mutual funds, and closed-end funds. These can be extremely powerful options to consider, which is why Chapter 12 gives you facts, figures, and important insights into what they are and how you can use them.

I personally prefer to buy up individual stocks instead of baskets of them. But I very well understand that everyone is different. Some of us prefer to play it as safely as possible. Some of us can afford to take greater (though not unreasonable) risks. And some of us choose a middle path between the two.

Whichever category you fall into, this book seeks to give you the kind of guidance you need to make it work for you.

IN THIS CHAPTER

- Exploring an incredible asset class that stands the test of time
- Understanding the ups and downs of real estate
- Collecting rent checks while you sleep well at night

Chapter 2

It All Starts with Real Estate

Real estate is the oldest asset class in the world, and one that's just as relevant today as it ever has been. Profitable too. According to Savills World Research, all the property in the world is worth an estimated $228 trillion. No other asset class comes even close to matching real estate in this regard, much less beating it:

- U.S. banks — $19.6 trillion
- Gold — $9.3 trillion
- Oil — $1.7 trillion

Why? What's so great about it? The answer is surprisingly simple. It's captured in the definition of real estate: "The land and any permanent structures, like a home, or improvements attached to the land, whether natural or man-made." That makes real estate a commodity that can accommodate shelter, commerce, food production, collaboration, and so much more. In fact, as I show throughout this book, real estate is necessary for doing just about anything on Earth.

As such, it's easy to break this massive asset class into several categories and subcategories. The largest of these, however, is *residential property:* houses that are used as homes. It's valued at around $169 trillion. *Commercial real estate* (property used to make money, such as office buildings, shopping centers, and apartment buildings), meanwhile, comes in at around $35 trillion.

The point is that real estate is the glue that holds the worldwide economy together. In this chapter, I explain why real estate is a dependable asset to have in your portfolio. Its growth over time is steady and remarkable. I also introduce you to some fundamental real estate concepts.

Land: They're Not Making It Anymore

Whether you believe it was Will Rogers (1879–1935) or Mark Twain (1835–1910) who said it, this statement is absolutely true: "Land: They're not making it anymore."

Because the world has all the land it will ever have, experts can put a value on it and use that number to measure other assets against it. In the following sections, I explain how supply and demand drives the value of real estate, look at the relationship between real estate and the gross domestic product (GDP) of countries around the world, and remind you that we'd be nowhere without real estate.

Supply and demand

As I point out in the chapter introduction, there's $228 trillion worth of real estate in the world. And that valuation will almost certainly climb further considering how it's such a finite asset class. It's a matter of supply and demand.

Supply and demand depend completely on the relationship between buyers and sellers. The former has to have something the seller wants, and the seller has to be willing to pay the price the buyer wants. Otherwise, it just doesn't work.

REMEMBER

When demand for a service or product is high, sellers have more control in setting the prices. A particular population wants it, and so a particular population will get it. That's what *demand* is: desire and the ability to act on that desire combined.

And when that desire and ability comes up against *low supply* — a limited amount of said service or product — sellers can really amp up the price. The wealthy win out in those cases, as do those willing to buy on credit, while the poorer and more prudent do without. Either way, the seller tends to win.

REMEMBER

When demand is low, that's when discounts enter the picture, as any retailer in a recession knows full well—or as any office landlord in this pandemic-inspired work-from-home paradigm knows full well. And, obviously, low demand and high supply is a bad thing. That means there's a lot of inventory to push at the lowest prices possible.

It's easy to see then that supply and demand are directly correlated. They work against each other until the product, service, or property in question reaches an *equilibrium:* the best estimate of what it's really worth in that moment. Figure 2-1 illustrates this principle.

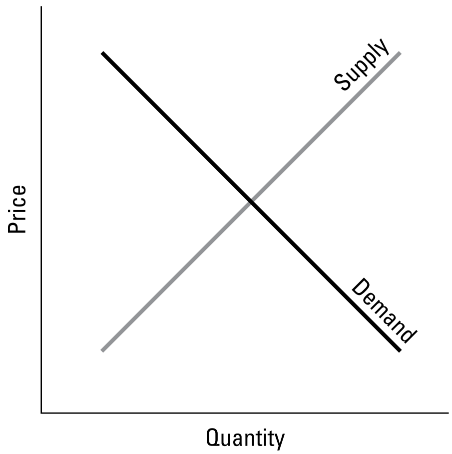

FIGURE 2-1: Supply and demand have a direct relationship.

Let's apply this to real estate. When demand for housing and commercial properties is high in a particular neighborhood or market, prices rise. We all saw this happen in the real estate market of 2020–2022, where the numbers of homebuyers skyrocketed. That prompted them to bid up home prices almost everywhere, which in turn, raised prices across the larger economy.

However, consider what happened after 2008 when the housing bubble burst and the Great Recession set in. Just like that, demand dropped, leaving a large unwanted supply of houses. Prices fell in order to attract the remaining buyers, who all of a sudden could be much more selective than they were before.

Decline in demand for real estate can also happen when a bull market overdoes it in general. Basically, sellers begin taking buyers for granted until buyers put their foot down and say "enough is enough. It's not worth the price. I'll rent instead." Again, this back-and-forth, push-and-shove, give-and-take dynamic always brings about a healthy balance. Eventually. And as it does, it keeps the real estate market ever changing.