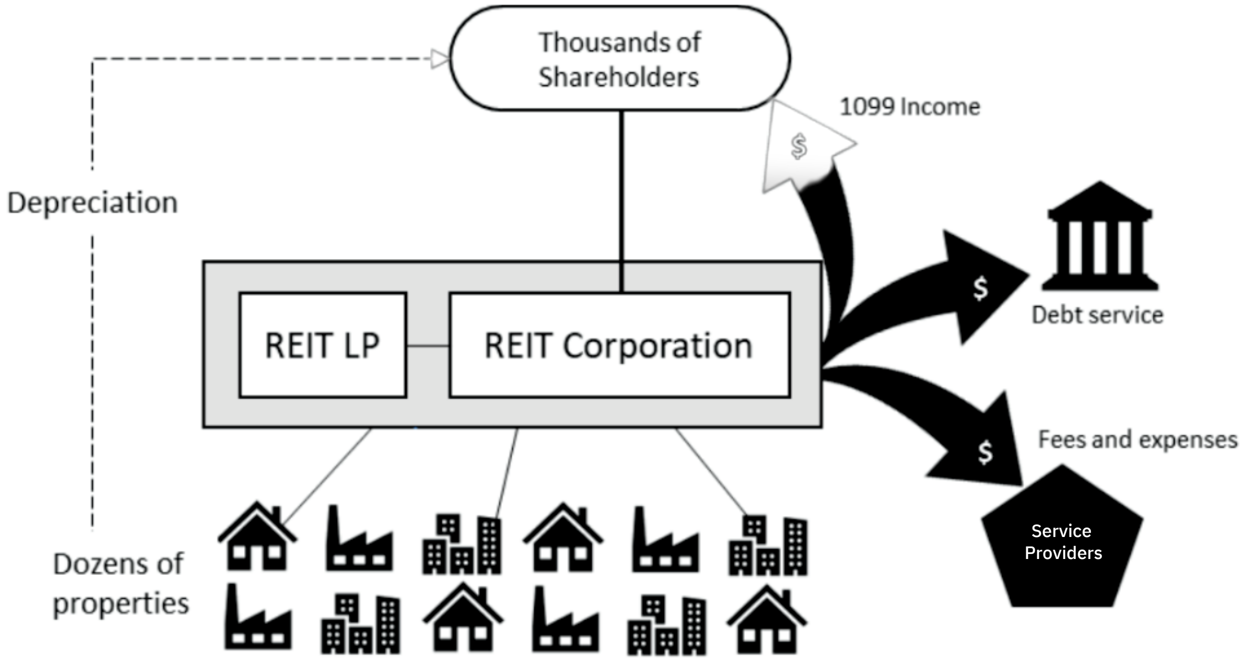
Real Estate Investment Trusts (REITs)

REITs typically comprise several or even hundreds of institutional-caliber investment properties or real estate-related debt instruments. REITs were developed to allow individual investors access to portfolios of large-scale, income-producing property while receiving a "pass-through" of real estate tax benefits. REIT types include apartments, warehouses, offices, shopping centers and healthcare facilities. Some REITs are diversified across multiple sectors, while others focus on a specialized niche.

In the 1960s, REITs were formed under a business trust structure—hence the "T" in REIT. But today most REITs are limited partnerships in which a corporation with public common shares is the general partner. To qualify as a REIT under IRS rules, a company must invest almost exclusively in real estate, and it must pass at least 90% of its taxable income to shareholders annually, usually as monthly or quarterly payments. Sometimes these payments are called "dividends," though technically they are "distributions."

A typical REIT structure:



People often confuse "listed" or "traded" securities with "public" securities. Many companies are registered publicly with the Securities and Exchange Commission (SEC) without selling their shares on a stock exchange. Examples of public, non-traded companies are mutual funds, interval funds and non-traded REITs.

In a "public" offering, its shares have been registered with the SEC. A public company is subject to numerous additional rules, ongoing reporting requirements and considerable compliance costs. With this public transparency comes the right to market nationally to a broad group of potential investors, subject to some state regulations.[1] Public offerings are sold subject to a registered prospectus. Conversely, the shares of a "private" company are not registered with the SEC, and therefore the sale of its securities are limited—typically to "accredited" investors.[2] These offerings are described in a Private Placement Memorandum (PPM).

Private companies are not required to comply with Sarbanes-Oxley audit rules and costly reporting requirements. However, many REITs that begin as private placements can be required to register as public companies after reaching a certain size.

TAXATION NUTSHELL—REIT investors receive a 1099, and the majority of distributions are taxed as ordinary income. However, taxpayers generally may deduct 20% of the qualified business income amount (through December 31, 2025).[3] REIT shareholders may offset their income with a pro-rata share of portfolio depreciation. Often the depreciation deduction nearly or entirely offsets investors' otherwise taxable income from a REIT. Of course, these deductions reduce cost basis, and will trigger depreciation recapture if REIT shares are liquidated before death. For many investors, deducting depreciation is a trade-off. Income tax is reduced today in exchange for a capital-gains tax in the future—unless the shares are passed to heirs and receive a "step up" in cost basis.

All traded or "listed" REITs are public, but not all public REITs are traded. Here are some key differences:

	Purchase	Sale	Share Price	Transaction Cost
Traded REITs	Shares bought on a national exchange	Shares sold on a national exchange	Price based on hourly fluctuations and highly correlated to stock market	Shared brokerage fees
Non-Traded REITs	Shares bought directly from issuer	Shares sold back to issuer per limited share redemption plan[4]	Price based on periodic valuations of underlying investment portfolio[5]	Offering costs, commissions, acquisition fees; back-end participation fees[6]

1. https://www.irs.gov/newsroom/facts-about-the-qualified-business-income-deduction
2. https://www.nasaa.org/wp-content/uploads/2011/07/g-REITS.pdf
3. https://www.sec.gov/oiea/investor-alerts-and-bulletins/private-placements-under-regulation-d-investor-bulletin
4. Share redemption plans are discretionary and can be suspended; funds available for redemption, if applicable, may be limited to only those funds received from dividend reinvestment, but many "Daily NAV" REITs offer annual aggregate liquidity up to 20% of the NAV of average outstanding shares
5. The frequency and methodology of valuations varies across non-traded REITs, and are based on appraised estimates in the absence of actual property sales
6. See the Use of Proceeds section of a REIT PPM to understand the full extent of fees, which vary across programs