

Real Estate Investment Trusts

Real Estate Investment Trusts, also known as REITs, are companies that own and operate income-producing real estate. To qualify as a REIT, a company must pay out at least 90% of its profit each year as dividends to shareholders. In return, the company is not required to pay income taxes. Taxes are paid by the shareholders.

The United States Congress passed the legislation which created REITs in 1960. Their goal was to provide investors, big or small, the opportunity to invest in large institutional-grade commercial real estate. For many investors, these types of properties were previously, unaffordable. Today, more than a dozen countries offer REITs and several more are considering legislation to create them.

There are approximately 200 publicly traded REITs in the United States. They can be categorized into three different types: Equity, mortgage, and hybrid. Equity REITs are the companies that own and operate income-generating real estate, while mortgage REITs make loans to real estate owners and operators. Hybrid REITs own, operate, and lend. Most REITs fall into the equity category. The U.S. public REIT market consists of the following property types:

Office Buildings	18%	Diversified	7%	Mixed	3%
Residential	17%	Lodging/Resorts	7%		
Regional Malls	14%	Health Care	6%		
Shopping Centers	12%	Specialty	5%		
Industrial	7%	Self Storage	5%		

REITs exhibit characteristics similar to those of both bonds and stocks. Like bonds, they provide a consistent stream of income (from rents and leases). They also hold the potential for long-term appreciation, like stocks (from underlying property values). On a risk scale, REITs fall between the two. Correspondingly, long-term returns for REITs have been between those for stocks and bonds as well.

In addition to consistent income and potential growth, REITs offer investors diversification benefits. Historically, the ups and downs in REIT returns have not moved in lockstep with those of stocks or bonds. Due to this low correlation, adding REITs to a portfolio reduces overall fluctuations in value.

REIT exposure also serves to defend against inflation. A major determinant of a property’s market value is its replacement cost. Since the labor and materials used to build real estate assets generally rise in cost along with inflation, the replacement cost and consequently, the market value of real estate tracks inflation closely.

For exposure to REITs, Vista favors exchange traded funds (ETFs) which track broadly diversified domestic and international REIT indexes. Low costs and broad diversification across property types make these vehicles the most appealing way to invest in REITs.