Real Estate and Your Portfolio

A traditional investment portfolio contains a combination of stocks, bonds, cash or cash equivalents, and the mutual funds or exchange traded funds (ETFs) that invest in those asset classes.

While some mix of traditional asset classes is likely to yield satisfactory investment returns for the average investor, you may also look for non-traditional opportunities, commonly known as alternative investments, to create a more comprehensive portfolio and address your specific investment needs. For example, you might consider an investment in rental real estate to diversify your potential sources of income.

Of course, before adding a new asset class like real estate to your portfolio, you'll want to be sure that you understand the risks as well as the potential advantages of this choice. With your financial advisor, you can investigate the ways in which different types of investments, including real estate investment trusts (REITs), can help you achieve your objectives.

What's A REIT?

A REIT is a corporation whose business is real estate. Using a pool of money it raises from investors, a REIT purchases buildings, or, less frequently, the mortgages on buildings. A REIT has a management team that's responsible for overseeing day-to-day operations and keeping the enterprise profitable. Among other things, REIT managers seek to provide a steady stream of revenue that underlies its distributions to investors. However, there is no guarantee that this objective will be met.

Types of Real Estate

Because REITs specialize in commercial real estate, investors have the opportunity to participate in a potentially profitable market to which they probably would not have access otherwise. Among the types of real estate a REIT might own are:

- **Office** complexes leased for corporate headquarters or professional services

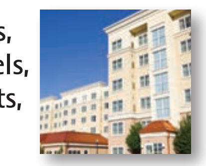
- **Multi-family** residential housing, including traditional apartment buildings

- **Healthcare** office space, hospitals, assisted living facilities, and other medical uses

- **Industrial** warehouses and distribution hubs

- **Retail** properties, including large shopping centers

- **Leisure** use properties, including resorts, hotels, golf courses, ski resorts, or amusement parks



- **Self-storage** space for individuals and small businesses

Traded and Non-Traded REITs

Some REITs are publicly traded and others are non-traded. There are important similarities between the two varieties but also major differences.

	Traded REITs	Non-Traded REITs
Overview	Filed with Securities and Exchange Commission (SEC) and publicly traded	Filed with Securities and Exchange Commission (SEC) but not publicly traded
Investment Objective	Current income and share price appreciation	Current income and eventual capital appreciation
Liquidity	May be bought and sold at any time. Either listed on an exchange or traded over-the-counter (OTC)	Investors should plan to hold through exit event
Volatility	Daily share price volatility based on supply and demand	No daily share price volatility until re-pricing 18 months after close of offering period, when underlying value of real estate holdings may fluctuate up or down
Investors	Available to any person or entity with a brokerage account	Available only to qualified investors through a professional financial advisor
Fees	Trading commissions at purchase; annual asset-based management fees	Front-end fees of 12% to 15% of investment; acquisition, asset management, disposition, and incentive fees during term

The Lifecycle of a REIT

Stage 1: The Start-Up

As it starts up, a REIT continues to raise funds to acquire properties and begins to gradually add properties to the portfolio. In evaluating its potential as an investment, it is critical to consider the track record of the firm offering the REIT. While past performance can never ensure success, it does provide valuable insight into the real estate purchases the management team made for earlier REITs and the way it operated those entities.

Stage 2: Buying Properties

In this stage, the REIT winds down its raising money efforts and focuses on acquiring the portfolio of properties the firm will manage. Income generation begins as rent payments provide cash flow to the REIT.

Stage 3: Ongoing Management

During the REIT operation period that can last up to 7 to 10 years, the sponsor manages its properties to produce an income stream.

Stage 4: Exit Event

REIT management seeks to monetize the portfolio in an effort to realize a capital gain for investors, although there's always the risk of a loss instead. To liquidate the portfolio, management may elect to sell the REIT properties as a single block or as multiple blocks. Alternately, it may choose to convert the corporation to publicly traded status through an Initial Public Offering (IPO). If the firm completes an IPO, investors may receive shares in the new publicly traded REIT or their share of the proceeds in cash. However, there is no assurance that the REIT will be able to liquidate.

While investing in a REIT may provide the potential for attractive returns, you take certain risks, just as you do when you make any investment. For example, if rental space isn't in demand, as sometimes happens, high vacancy rates can limit the distributions you receive. Similarly, if tenants default or declare bankruptcy, the REIT's income and consequently its distributions may be reduced.

Another risk may occur during the early stages of a REIT as it begins to purchase properties. Until the acquisition phase is complete, rental income may not be adequate to cover distributions. As a result, the REIT may choose to reduce the distributions it has promised or borrow to pay the distributions. The REIT may also pay distributions from offering proceeds, a fact that would reduce the amount available for acquiring additional properties and could reduce the REIT's overall return.

In fact, the amount of the distributions a REIT pays may decrease at any time. Due to the risks involved in the ownership of real estate, there is no guarantee of any return on an investor's investment, and an investor may lose all or a portion of his or her investment. And while a REIT can offer tax advantages, failing to qualify for REIT status would adversely affect a REIT's operations and ability to make distributions. Investors should consult with their tax advisors regarding the tax implications involved with a REIT Investment.

Non-traded REITs are not bought and sold on an exchange and are therefore not immediately available to liquidate. Investors should be prepared to seek liquidity from other pieces of their investment portfolio.

Is a Real Estate Investment Trust Right for You?

What comes to mind when you think about investing in real estate? Buying a new home—or a second home? Purchasing apartments or commercial buildings you can manage and rent to provide income? Finding undeveloped land in a part of the country you think is destined to grow?

What you may not think about are shopping centers, office complexes, healthcare facilities, or low-income residential housing. Yet these income-producing commercial real estate investments, which in the past were primarily available only to institutions, are now more generally accessible through real estate investment trusts (REITs).

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Guide to Understanding Real Estate Investment Trusts

An investment in knowledge pays the best interest.
– Benjamin Franklin