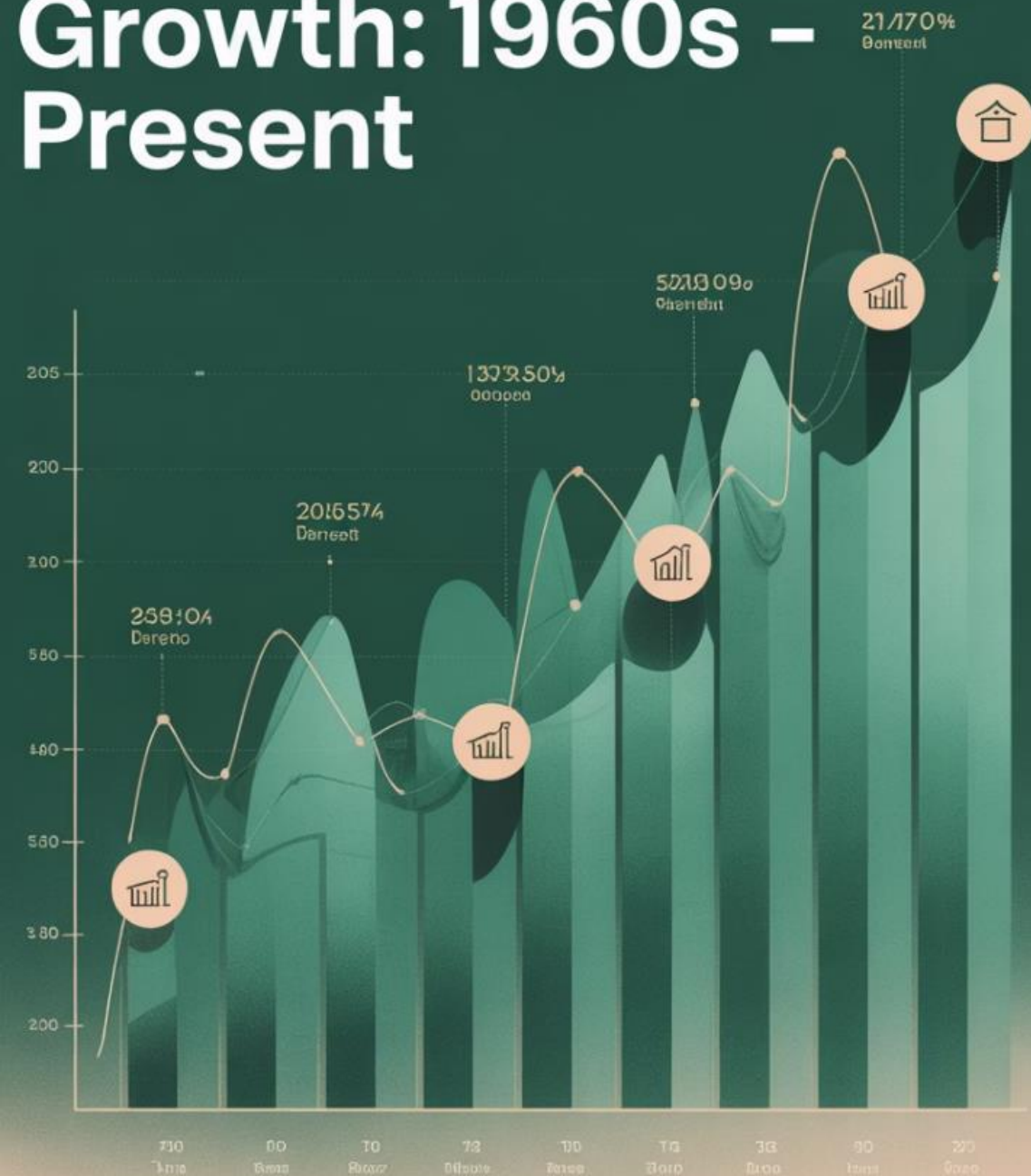


# Understanding Real Estate Investment Trusts (REITs)

REITs offer a unique investment vehicle that bridges public stock markets and private property markets. They provide investors liquid access to real estate while offering property owners access to public equity markets.



# REIT Market Growth: 1960s – Present



## The Evolution of REITs

1

### 1960s Origins

Created by U.S. Congress in 1960 to give small investors access to diversified real estate portfolios.

2

### 1986 Reform

Removal of external management requirement sparked the "Modern REIT Era" of the 1990s.

3

### Global Expansion

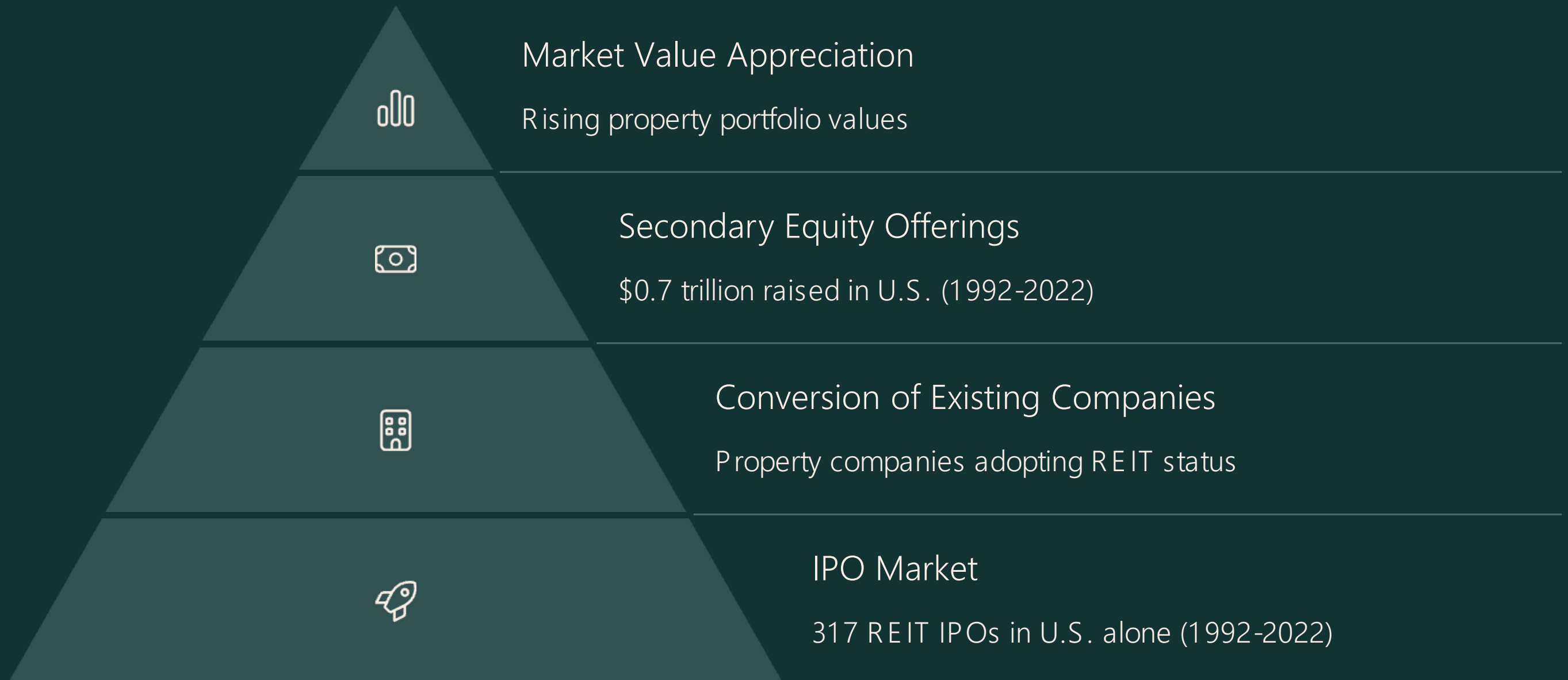
By 2022, REITs existed in at least 37 countries with \$1.9 trillion market capitalization.

4

### Today's Market

Over 600 listed REITs worldwide, with increasing institutional investment.

# REIT Market Growth Sources



# Shifting Property Focus

## 2000 REIT Market

Traditional commercial real estate dominated the market:

- Office buildings
- Multi-family residential
- Retail properties
- Industrial facilities

These four categories represented over 75% of U.S. REIT market capitalization.

## 2025 REIT Market

Alternative categories gained significant market share:

- Infrastructure
- Healthcare facilities
- Student housing
- Single-family rentals (SFR)
- Self-storage facilities
- Data Centers

Office and retail lost their preeminence in the market while infrastructure and residential has increased.

# Vertical Integration of Modern REITs



## Land Acquisition

Raw land acquisition and "land banking" for future development

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## Development

Construction of structures on acquired land

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## Property Ownership

Holding stabilized operational properties as investments


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## Property Management

Operational management and tenant services



A background image showing a wooden desk with several books, a calculator, and a pen. The books are open, showing financial or accounting data. The calculator is a standard desktop model. The pen is a silver ballpoint pen. The overall scene suggests a professional or academic setting.

# REIT Regulatory Requirements for favorable pass-through tax treatment

## Distribution Test

At least 90% of annual taxable income must be distributed to shareholders as dividends each year.

## Asset Test

75%+ of total assets must be real estate, mortgages, cash, or federal government securities.

## Income Test

At least 75% of income must come from passive sources like rents and mortgage interest.

## Ownership Test

No five or fewer individuals may own more than 50% of stock, and must have at least 100 shareholders.



# International REIT Regulations

Country	Distribution Requirement	Leverage Ceiling	Cross-Border Investment
United States	90% of income	No specific limit	Allowed
Australia	100% of income	No specific limit	Allowed
Japan	90% of income	No specific limit	Allowed
France	95% of income	No specific limit	Allowed
UK	90% of income	No specific limit	Allowed

# REIT Income Measures



## Potential Gross Income (PGI)

Total potential revenue if properties were fully leased



## Net Operating Income (NOI)

PGI minus vacancy and operating expenses



## EBITDA

NOI minus general and administrative expenses



## Funds From Operations (FFO)

EBITDA minus interest expenses



## Adjusted FFO (AFFO)

FFO plus depreciation minus capital expenditures



# Valuing REITs: Two Approaches

## Cash Flow Approach

Views REIT as a stream of future cash flows:

- Uses Gordon Growth Model
- Considers dividend growth rate
- Accounts for plowback ratio
- Evaluates management's ability to find growth opportunities

Formula:  $E = \text{DIV}_1 / (r - g)$

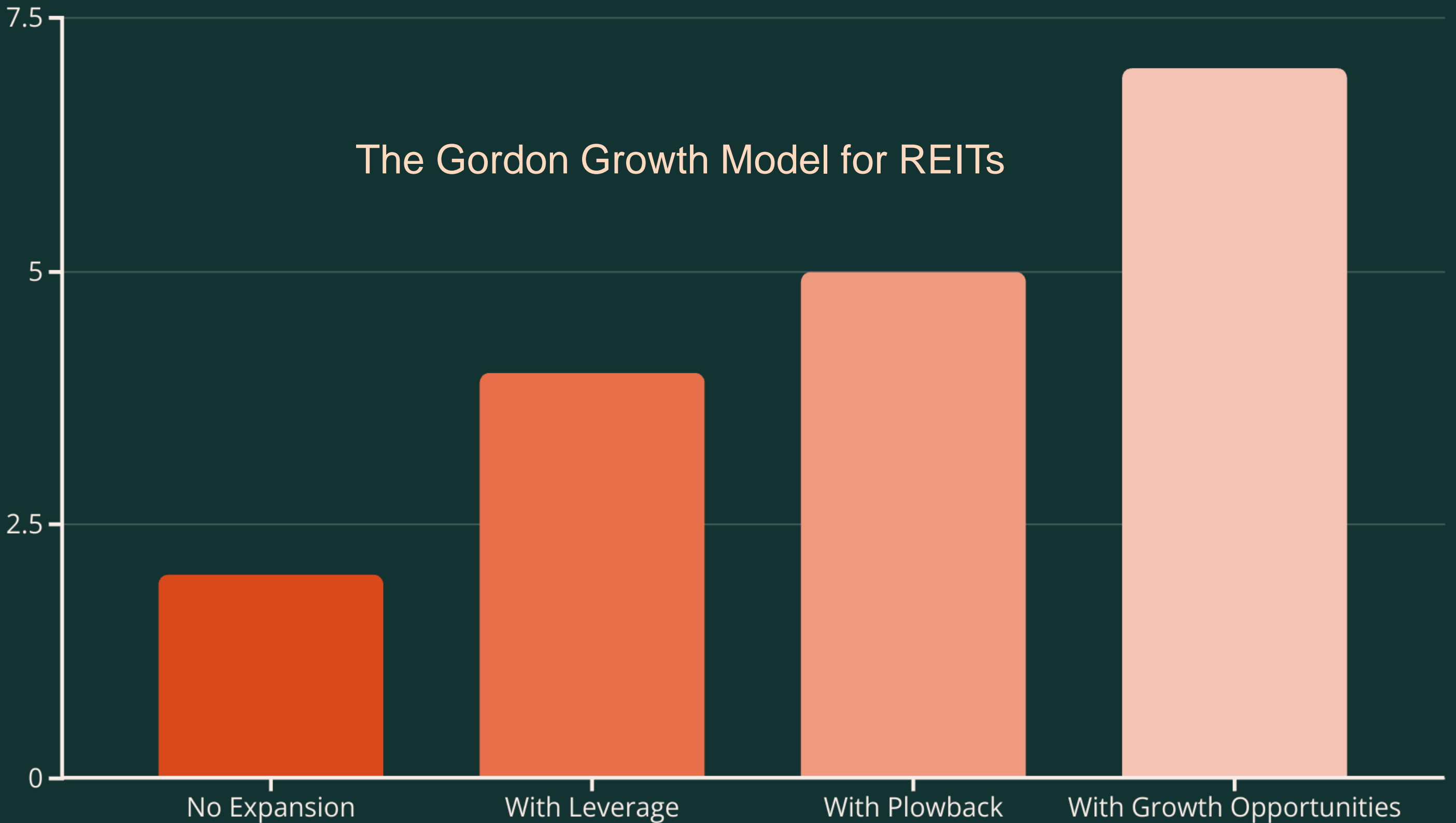
## Net Asset Value Approach

Views REIT as a collection of real estate assets:

- Estimates value of all properties
- Adjusts for non-asset-based value
- Subtracts liabilities
- Divides by number of shares

Compares Price/NAV ratio to identify potential mispricing

## The Gordon Growth Model for REITs



# REIT Public/Private Arbitrage (Public Values to NAV)

If REIT Share Values Are Higher

Sell shares: REITs buy properties in private market at lower valuations

Income Focus

REITs become income stocks with lower P/E multiples



Growth Opportunity

REITs become growth stocks with higher P/E multiples

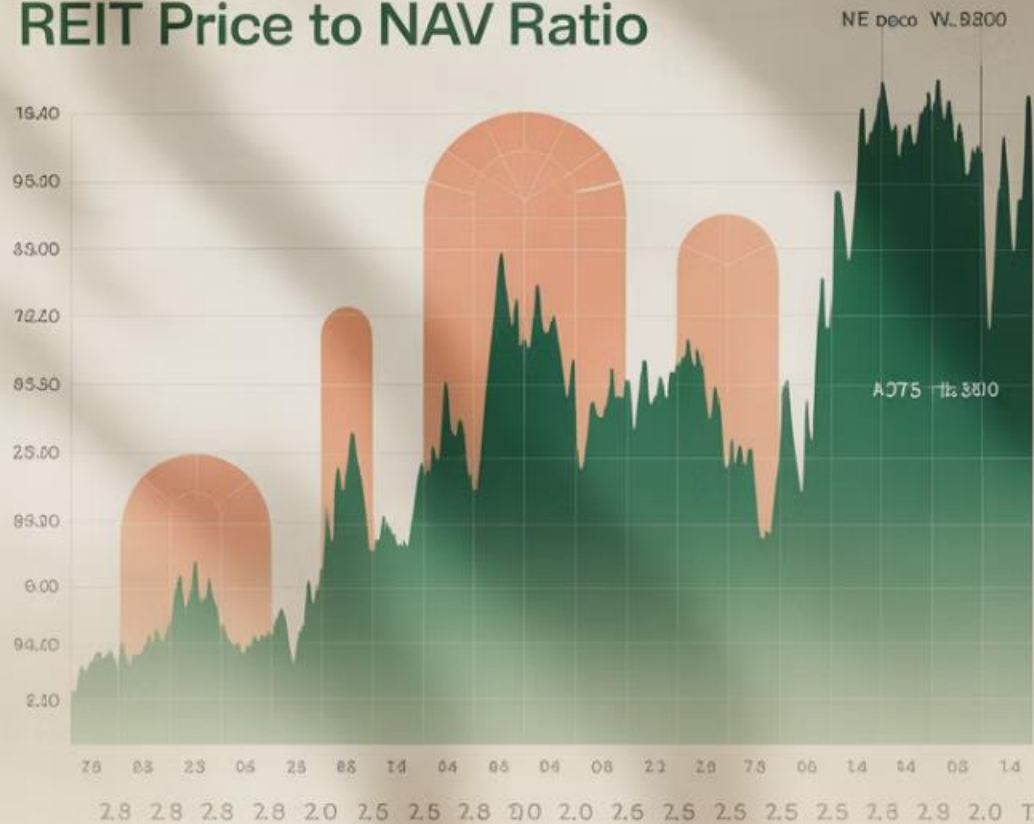
Private Market Values Higher

REITs sell properties into private market at premium and buy back their own stock shares.

# REIT Price to NAV Ratio History

REIT CTOLICIAI RPAIO

## REIT Price to NAV Ratio



75%

2009 Low

During financial crisis,  
REITs traded at deep  
discounts to NAV

120%

2016 Peak

Premium pricing  
reflected growth  
opportunities

95%

2022 Average

Near parity between  
public and private  
valuations

The premium or discount of REIT share prices to their Net Asset Value follows a mean-reverting pattern. This creates opportunities for strategic capital deployment between public and private markets.



# REIT Management Strategies



## Specialization

Focus on specific property types allows management expertise and easier market market analysis. Modern REITs typically specialize in one or two related property types.



## Vertical Integration

Controlling multiple stages of real estate production provides flexibility to profit from changing market valuations while maintaining operational scale.



## Scale Economies

Larger REITs may benefit from lower average costs and improved capital access. Average REIT size grew from \$212M in 1984 to \$3B in 2022.



## Branding

Building brand recognition among space users can create franchise value, especially for consumer-facing properties like retail and housing.



# REIT Financial Strategy Balancing Act



# REIT vs. Private Real Estate Investment

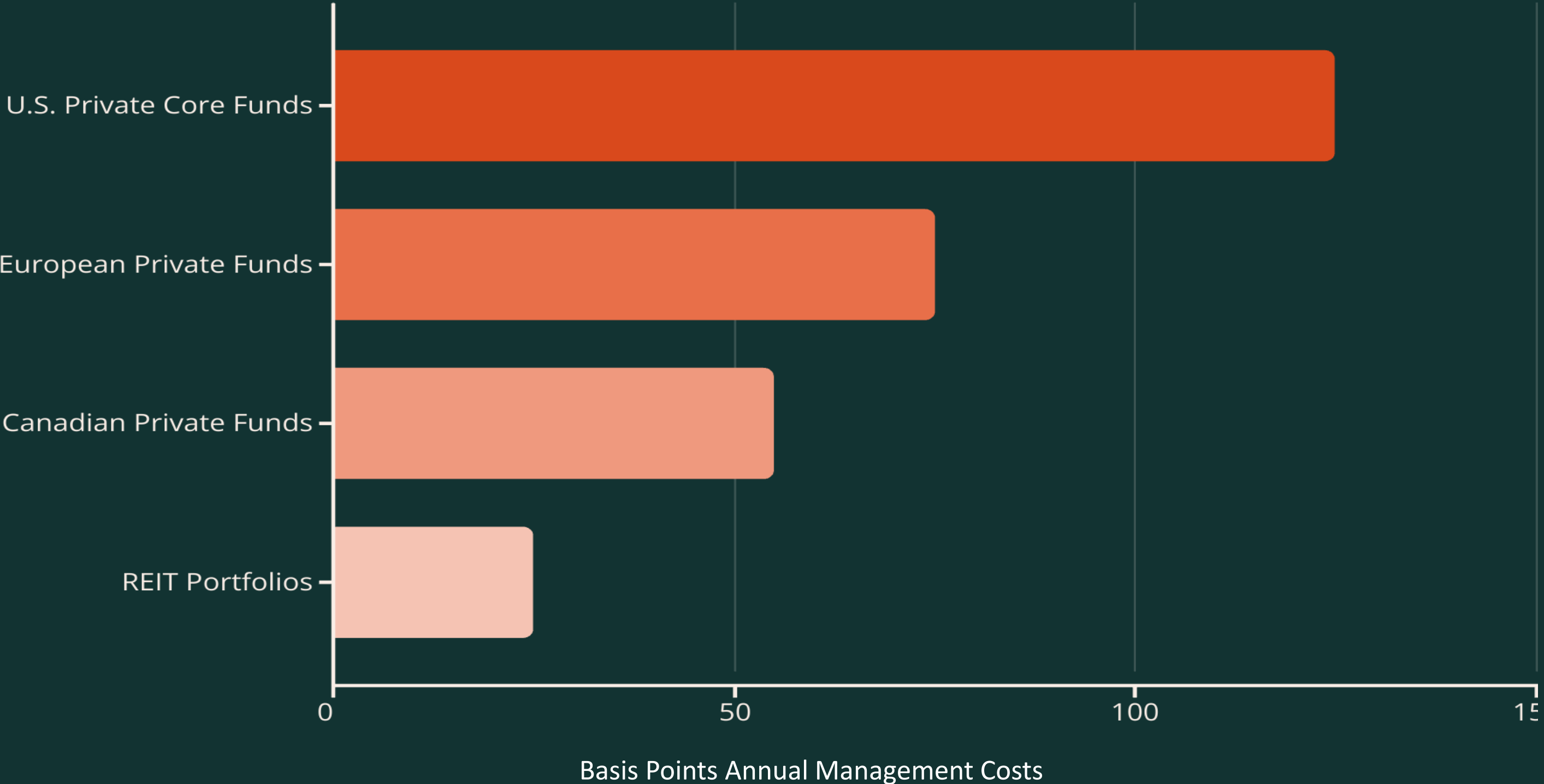
## REIT Advantages

- Greater liquidity
- Lower management costs ( $\pm 25$  basis points)
- Professional management
- Access to niche property types
- Smaller minimum investment

## Private Real Estate Advantages

- Better portfolio diversification
- Lower correlation with stocks
- Less market volatility
- More control over property selection
- Potential for direct value creation

# REIT Investment Management Costs Are Much Lower than for Direct Private Funds





# REIT Stock Market Characteristics



## Low Beta Stocks

REITs generally have lower volatility relative to the overall market, but are not zero-beta investments.



## Small Cap Correlation

REITs show higher correlations with small-cap stocks than with large-cap stocks.



## Leverage Impact

Changing patterns in betas and correlations are mainly attributable to industry-wide dynamics in REIT leverage.

# REIT Growth vs. Income Classification

## Growth Stocks

When stock market values property higher than private market, REITs can grow by acquiring properties. This creates higher price/earnings multiples.

## Income Stocks

REITs typically function as income stocks with stable dividends. They often have lower price/earnings multiples than growth stocks.

## Shrinking Stocks

When private market values property higher than stock market, REITs can create value by selling properties and buying their own stock or going private through leveraged buyouts.



# REIT Market Volatility



REITs experience significant market volatility. During the 2008 financial crisis, U.S. REIT share prices fell 75% from peak to trough. However, REITs maintained access to equity markets even during crises, with \$24 billion raised in 2009.



# The Future of REITs



## Global Expansion

Continued adoption of REIT structures in markets



## Innovation

Pioneering investment in new alternative property types.



## Institutional Growth

Increasing allocation from large institutional investors



## Consolidation

Continued industry consolidation as scale advantages persist

REITs have evolved from a slow-starting investment vehicle in 1960 to a global industry with \$1.9 trillion market capitalization. Their ability to provide tax-efficient, liquid real estate exposure ensures their continued importance in investment portfolios.

