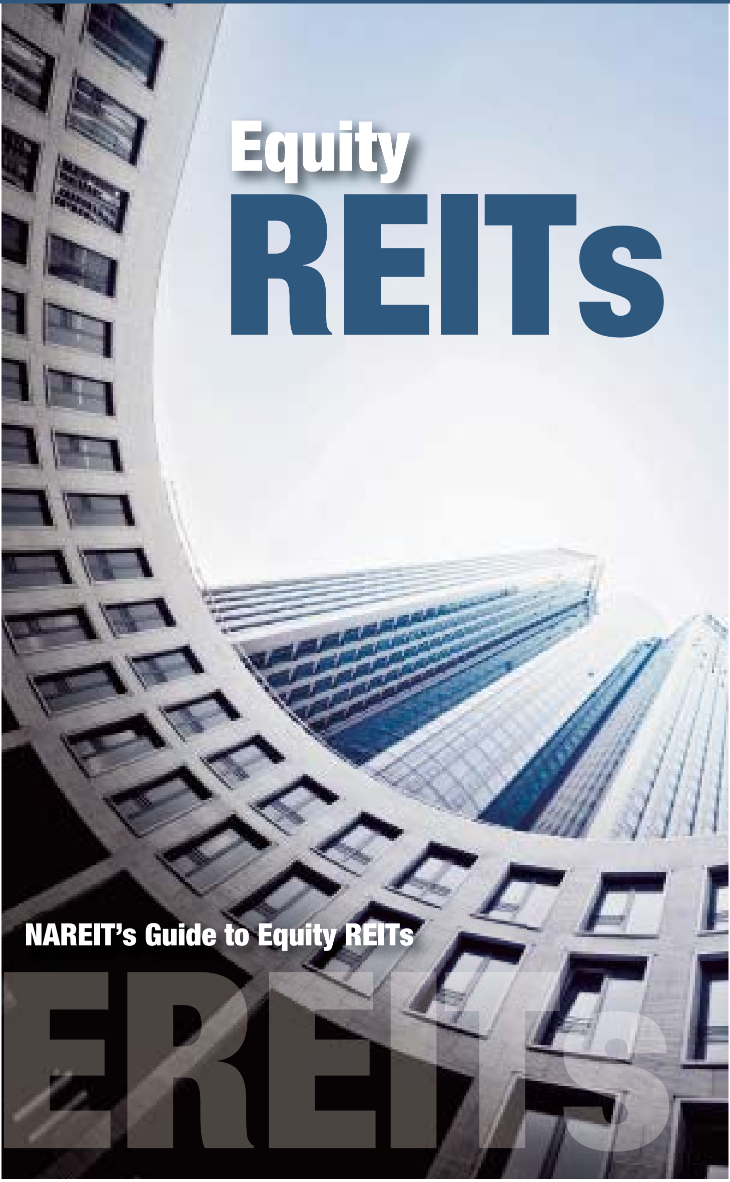
National Association of
Real Estate Investment Trusts®
REITs: Building Dividends & Diversification®

March 2014

Equity REITs



NAREIT's Guide to Equity REITs

REITs

Real Estate Investment Trusts are a type of real estate investment company authorized by Congress in 1960 to provide individuals from all income levels the opportunity to invest in income-producing real estate. Congress understood then - as it does now - the important and diverse role real estate plays in the U.S. economy as well as with respect to investment opportunity.

Over the past five decades, REITs have supported the growth of the U.S. economy by effectively and efficiently channeling capital into real estate, bringing greater transparency to real estate investment, creating liquidity in the real estate sector of the economy and contributing to the nation's tax base.

REIT History

The original legislation authorizing REITs in the United States was passed by Congress in 1960 and signed into law by President Dwight D. Eisenhower. This legislation was patterned after the legislation governing mutual funds, and it shared a similar objective: to provide a means "whereby small investors can secure advantages normally available only to those with larger resources."

Real estate is a distinct asset class, and real estate equities are different from other stocks, bonds and cash holdings. The investment characteristics of real estate – the potential for current income generation, long-term capital preservation and appreciation, portfolio diversification and inflation protection – had long been enjoyed by large investors who could purchase investment-grade, income-producing properties directly. REITs democratized real estate investment by giving all investors the ability to gain these same benefits by buying the stocks of real estate companies operating as REITs.

The REIT Rules

To ensure that REITs provide investors with the same type of benefits as direct real estate investment, Congress in 1960 established an operating framework requiring that REITs invest primarily in real estate. Specifically, at least 75 percent of a REIT's total assets must be invested in real estate; and at least 75 percent of gross income must be derived from real estate sources, such as rents from real property, interest from mortgages on real property or sales of real estate investments. REITs also must be widely held, with more than 100 shareholders and no fewer than five individuals owning more than 50 percent of their stock.

A cornerstone element of the original REIT legislation requires REITs to distribute the bulk of their taxable income — at least 90 percent — annually to their shareholders as dividends. Most REITs today pay out 100 percent of their taxable income as dividends.

Like mutual funds, REITs are able to deduct from their corporate tax liability the amount that they pay out as dividends. Shareholders pay tax on the dividend income they receive, generally at ordinary income tax rates. This dividend distribution requirement is fundamental to the ability of REITs to deliver the potential income and performance benefits of investment in real estate.

Types of REITs

There are two primary types of REITs: Equity REITs and Mortgage REITs. The two types give investors the opportunity to invest in either the equity financing or the debt financing of real estate.

Equity REITs are real estate companies that acquire commercial properties – such as office buildings, shopping centers and apartment buildings – and lease the space in the structures to tenants, who pay rent. After paying the expenses associated with operating their properties, Equity REITs pay out annually the bulk of the income they collect to their shareholders as dividends. Equity REITs also include capital appreciation from the sale of properties in the dividends they pay. In the case of Timber REITs, their dividends include gains from the sale of timber. In all cases, this significant dividend distribution is designed to approximate the investment return investors would receive if they owned properties directly.

Mortgage REITs invest in real estate mortgages or mortgage-backed securities, earning income from the interest on these investments, as well as from the sales of mortgages. Mortgage REITs, like other businesses, earn their profit from the difference between the income they receive and their costs, including their funding costs to purchase mortgage investments. They have the same requirement as Equity REITs to distribute the bulk of their income to their shareholders annually.

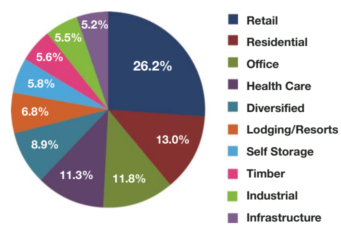
Public Equity REITs and Mortgage REITs may be listed on major stock exchanges, or they may be non-listed. Both are registered with the Securities and Exchange Commission (SEC), but non-listed REITs are sold directly to investors by brokerage firms and are not traded on any exchange. Equity and Mortgage REITs also can be privately held.

Today's U.S. Equity REIT Market

Equity REITs constitute the bulk of today's REIT market. Stock exchange-listed Equity REITs account for 70 percent of all U.S. listed REIT assets, and 90 percent of the approximately $700 billion equity market capitalization of the listed REIT marketplace is represented by Equity REITs. There are approximately 150 listed Equity REITs, almost all of which are traded on the New York Stock Exchange.

Listed Equity REITs own more than $1 trillion of real estate assets in the U.S., including more than 40,000 properties in all 50 states and the District of Columbia. The assets of Equity REITs account for an estimated 15 percent of total U.S. commercial real estate assets, and Equity REITs directly or indirectly support some 1 million U.S jobs.

Property Sectors for Listed Equity REITs



Source: NAREIT

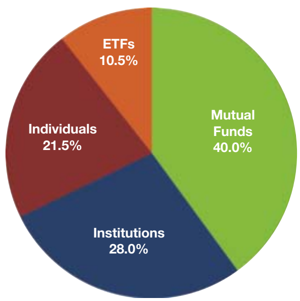
In drafting the original REIT legislation, Congress established a broad definition of real estate because it understood that the role and uses of real estate in a dynamic economy would change over time along with economic growth and changing technology.

Consequently, there are Equity REITs today that own real estate tied to almost all sectors of the economy. The holdings of these REITs take the form of properties including apartments, shopping centers, warehouses, hotels, storage facilities, hospitals and clinics, senior living facilities, offices, data centers, telecommunications towers and timberlands.

The growth of the listed Equity REIT market has moved REITs into the investment mainstream. As of Dec. 31 2013, 80 listed Equity REITs with a combined equity market capitalization of approximately $500 billion were represented in the S&P Equity Indexes.

The investment appeal of Equity REITs also has spread around the world. Today, approximately 30 countries have adopted their own REIT legislation, based primarily on adaptations of the U.S. model. Every G-7 nation has adopted REIT legislation, as have a majority of the member countries of the Organisation for Economic Cooperation and Development.

Listed Equity REIT Ownership



Source: Citi Research, SNL, Bloomberg, FactSet, Lipper

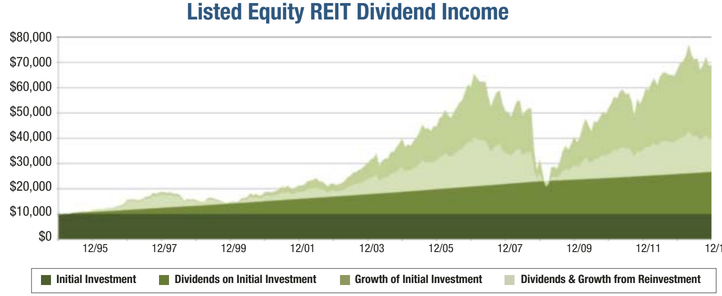
Characteristics of Listed Equity REIT Investment

Dividend Income

The high dividend payout requirement for REITs means that a larger share of REIT investment returns comes from dividends when compared with other stocks. For this reason, many financial advisors consider Equity REITs to be well-suited for investors seeking income, as well as for long-term investors seeking both income plus capital appreciation.

Listed Equity REIT dividend yields have historically been higher than the average yield of the S&P 500 Index. In fact, over the long-term, more than half of listed Equity REIT total returns have come from dividends.

Listed Equity REIT Dividend Income



Source: NAREIT

For investors with a longer time horizon to retirement, dividends can be reinvested to generate future returns, while in later years they can provide a steady income stream to help meet expenses in retirement. As the chart above shows, an original $10,000 investment in the FTSE NAREIT All Equity REITs Index at the beginning of 1994 would have grown to $69,094 by the end of 2013 if dividends had been reinvested. If dividends had been taken as income, the original $10,000 investment would have paid out $16,699 in dividends and delivered another $13,351 in growth, for a total value of $30,090.

Portfolio Diversification

Listed Equity REITs have provided important diversification benefits for investors due to their relatively low correlation with other assets, including other stocks and bonds. Diversification with listed Equity REITs has helped to improve returns without increasing overall portfolio volatility.

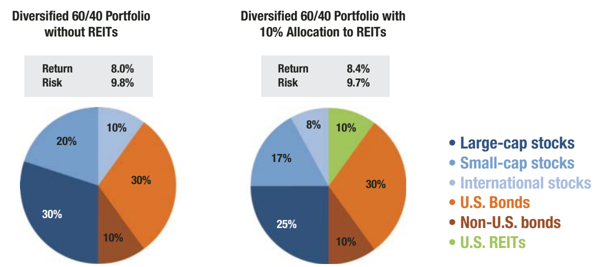
Diversification aims to reduce portfolio volatility, the risk that investors will see large up-and-down cycles in the value of their portfolio holdings. Some investors may seek to reduce volatility by diversifying a portfolio, for example, between small-cap stocks and large-cap stocks.

However, this strategy only divides a portfolio between different parts of the same asset class and does not achieve the full benefit of diversification. A widely accepted approach to portfolio diversification is to also diversify among asset classes.

Listed Equity REITs, for example, have had less of a tendency to move in tandem with other equities when stocks go up or down. Over the 20-year period from the beginning of 1994 to year-end 2013, large-cap and small-cap equity total returns were 81 percent correlated, while large-cap equity and listed Equity REIT total returns were only 56 percent correlated. So, diversifying a large-cap portfolio with listed equity REITs would have been more effective at achieving diversification.

A key portfolio benefit of diversification is the potential to increase long-term returns without taking on additional risk. The chart below illustrates how reallocating 10 percent of a diversified 60 percent stock/40 percent bond portfolio to listed Equity REITs would have improved annual returns by 0.2 percent per year on average from the beginning of 1994 to the end of 2013. That could add up to thousands of dollars of potential additional gains over 20 years without any additional risk.

Listed U.S. Equity REITs Have Increased Returns, Decreased Risk



The potential to increase returns and reduce risk by including Equity REITs December 1992-December 2012
Source: Large-cap stocks-Standard & Poor's 500® Small cap stocks-Russell 2000; International stocks-Morgan Stanley Capital International Europe, Australia, and Far East (EFEA®) Index; U.S. bonds-Barclays Capital U.S. Aggregate Bond Index; Non-U.S. Bonds-BarclaysCapital Aggregate ex USD; U.S. REITs-FTSE NAREIT All Equity REIT Index.

Inflation Hedging

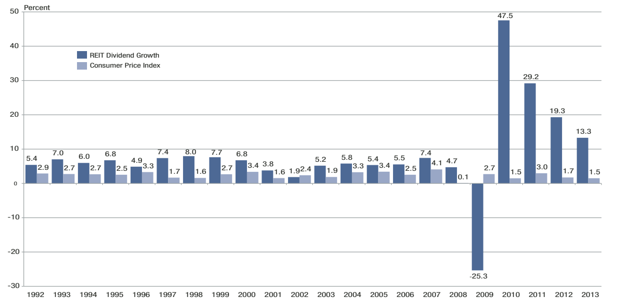
A key concern for many investors today is how to ensure enough income for a retirement period that could last for decades. Even in a low-inflation environment, the cumulative effects of inflation over long periods can erode the purchasing power of portfolio assets. The dilemma for retirees is that it can be tough to stay ahead of inflation with fixed income securities, while equities – the traditional inflation hedge – are usually trimmed back to reduce investment risk.

Listed Equity REITs have provided, in part, a natural hedge against inflation in ways that match up well with investors' needs. Commercial real estate rents and values have tended to increase when prices do, which has supported Equity REIT dividend growth, providing retirement investors with reliable income even during inflationary periods.

A practical way of measuring the inflation protection provided by listed Equity REIT dividends is to directly compare dividend growth with inflation. In all but two of the last 20 years, the annual growth rate of listed Equity REITs' dividends has outpaced inflation as measured by the Consumer Price Index.

Listed Equity REIT Dividend Growth vs. CPI

1992-2013

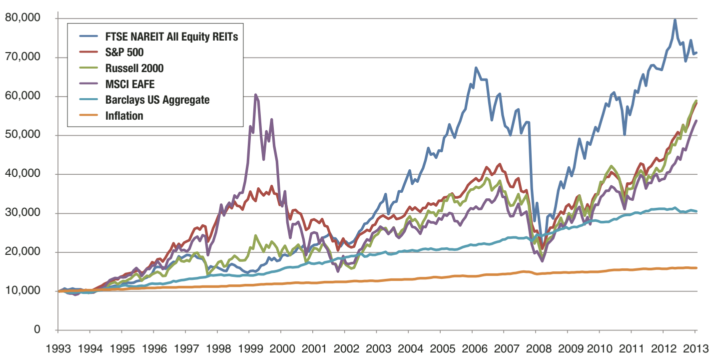


Source: NAREIT, SNL Financial

Total Return Performance

Over the past 20 years, listed Equity REITs have provided appreciable and competitive returns driven by dividend payouts and capital appreciation. U.S. listed Equity REITs delivered an average annual total return of 11.16 percent compared to 8.22 percent for the S&P 500 Index for the 20-year period through 2013. The chart below shows listed Equity U.S. REIT total return performance for that period compared to U.S. and international stock and bond market benchmarks. A $10,000 original investment in U.S. Equity REITs at the beginning of the period would have grown to $71,285 at the end of the 20-year period, while the same investment in the S&P 500 would have grown to $58,352.

Total Return Performance



Source: *Large-cap stocks – Standard & Poor's 500®; Small-cap stocks – Russell 2000; International stocks – Morgan Stanley Capital International Europe, Australasia, and Far East (EAFE®) Index; U.S. bonds - Barclays U.S. Aggregate Bond Index; U.S. REITs – FTSE NAREIT All Equity REIT Index, Inflation – Consumer Price Index.*

Liquidity and Transparency

For many years, investors considered real estate the ultimate immovable, illiquid asset. However, the liquidity of Equity REITs listed on major stock exchanges makes real estate investing fast, easy and efficient.

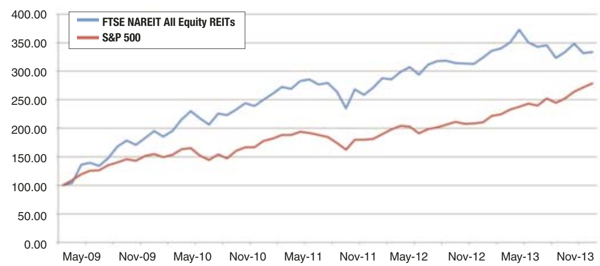
Listed Equity REITs also provide market transparency for investors, with real-time pricing and valuations. As with other stocks, investors can get in and out of their investments to optimize their exposure to real estate. Listed Equity REITs in the U.S. are also registered and regulated by the SEC, ensuring adherence to SEC standards of corporate governance, financial reporting and information disclosure.

A Stabilizing Force in the Real Estate Marketplace

The listed Equity REIT industry is required to invest for the long-term, and has a track record of generating current income and using moderate leverage. The industry also provides transparent financial statements and other financial disclosures, and is widely monitored by analysts, investors and the financial media. Because of these factors, some academic researchers, including the University of Wisconsin's Timothy Riddiough, have argued that listed Equity REITs serve as a stabilizing force within the real estate market and the broader economy during times of economic turbulence.

The resilience of listed Equity REITs in recovering from sharp declines in values during the 2008–2009 global financial market crisis also is noteworthy. From the beginning of the equity market recovery in March 2009 through 2013, listed U.S. Equity REITs delivered an average annual total return of 28.3 percent compared to 23.6 percent for the S&P 500 Index.

U.S. Listed Equity REITs vs. S&P 500 Stocks



Source: NAREIT

Who Invests in Equity REITs?

Listed Equity REITs are prominent in today's investment landscape. They are included in 225,000 401(k) plans, representing 50 million individuals. There are approximately 200 mutual funds and ETFs dedicated to stock exchange-listed REITs sponsored by major investment management firms like Vanguard, Fidelity and T. Rowe Price. Additionally, REITs are in a majority of target date funds, the fastest-growing retail investment default option, and most pension fund and endowment portfolios.

Risks of Investing in Equity REITs

While listed Equity REITs are an investment in the real estate asset class, they also are stocks. Like other stocks, their prices are influenced by market conditions and may rise or fall. Additionally, while the real estate market cycle is different from the market cycles for other equities, commercial real estate is a cyclical business. Changes in the values of the property portfolios owned by listed Equity REITs affect the valuations of their shares.

NAREIT's Guide to Equity REITs

National Association of Real Estate Investment Trusts®
REITs: Building Dividends & Diversification®

REIT.com
BROUGHT TO YOU BY NAREIT

1875 I St., NW, Suite 600, Washington, DC 20006-5413
202-739-9400 • 800-3NAREIT • REIT.com