Opportunities in Real Estate Investment Trusts

If you own your home and perhaps a second home, you may still want to expand your real estate holdings. Buying stock in real estate-related companies offers investors a way of participating in property ownership, often with greater liquidity and less personal involvement than through direct ownership.

In the past, real estate investing stood on three bases: 1) current tax advantages; 2) capital gains tax advantages; and, 3) income. Most real estate investing was done privately, enabling investors to use current tax breaks to offset wages and salaries. They could then convert increases in property values into capital gains which were taxed at preferential rates. These two advantages are eliminated under current tax law, and all that remains as an investment objective is income.

What does this mean for the individual investor? Even at a time of sluggishness in many sectors of the real estate industry, small investors have an excellent opportunity for potentially profitable results in high quality real estate investment trusts--**Real Estate Investment Trusts (REITs)**.

A REIT is a corporation, association, or trust that owns real estate outright (an equity REIT), property loans (a mortgage REIT), or a mixture of both (a hybrid REIT). They are typically managed by real estate professionals whose specialized knowledge of the various sectors of the real estate market have allowed them to succeed in building highly profitable portfolios of real estate holdings. REITs are highly liquid assets, regularly traded on exchanges in the same manner as other stock.

By law, a REIT that distributes at least 95 percent of its income to its investors can elect to be taxed only on the remaining 5 percent (or less) of retained income. This means that shareholders, of whom there must be at least 100 for REIT qualification, receive dividends that are subject to only one incidence of taxation.

In order to qualify for tax treatment as a REIT, a trust must observe strict rules on the derivation and distribution of income, and undergo quarterly source-of-income tests. A REIT that meets all tests is taxed at regular corporate tax rates on retained earnings and profits. Shareholder distributions are taxed as ordinary income, except for distributed capital gains of the trust, which are taxed as long-term capital gains.

The "better" REITs own desirable properties that usually are fully rented. The best current opportunities in REITs would appear to be in health-related real estate, such as hospitals and nursing homes, apartments in areas of the country that are seeing growth, and shopping centers, again in areas where the economic picture has stabilized. REIT "managers," or trustees, must hold legal title to the properties and must have specific legal responsibilities for them. Financial institutions, insurance companies, and closely-held corporations are excluded from such qualification.

For a diversified portfolio of REITs and other real estate stocks, a mutual fund may provide a successful alternative. There are several funds available which offer a diversified assortment of individual investments. However, each financial strategy should include considerations about which REIT will best impact on your particular long-term goals.

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