SECURITIZED REAL ESTATE MARKETS

TOPICS

- REITS and Liquid Real Estate — Ch. 21/22
- REIT Market Performance — Ch. 24/26

REITs and Liquid Real Estate

- REITs (Real Estate Investment Trusts) were created by Congress in 1960 to make investments in large scale, income producing real estate accessible to all investors

- REITs were not a major force until the early 1990s, as banks, insurance companies, tax syndicates, and pension funds provided the bulk of capital for real estate.

C-Corps vs. REITs

Structure	Pros	Cons
C-Corp	- Can retain more cash flow for growth - Simpler corporate structure - No limitations on the types of businesses performed	- Pay corporate tax
REIT	- No corporate tax	- Large Dividend payments - More dependent upon equity specialists to raise growth capital - Numerous operating restrictions
Partnerships	- No corporate tax	- Tax liability without distribution - Cumbersome governance structure

REIT vs. Publicly Traded Real Estate Companies

- The REIT decision revolves around the gains from single taxation (estimated at 3-5% of the value of the assets) versus the costs of the operating restrictions.
- If you believe more value is created by avoiding double taxation than is destroyed by the operating restrictions, you will select REIT status.
- One reason why most private companies are not REITs, is that to qualify as a REIT you must have a least 100 shareholders, and no 5 shareholders taken together can control 50% of the equity. At least 90% of the taxable income has to be distributed as dividends.

Public Vs. Private

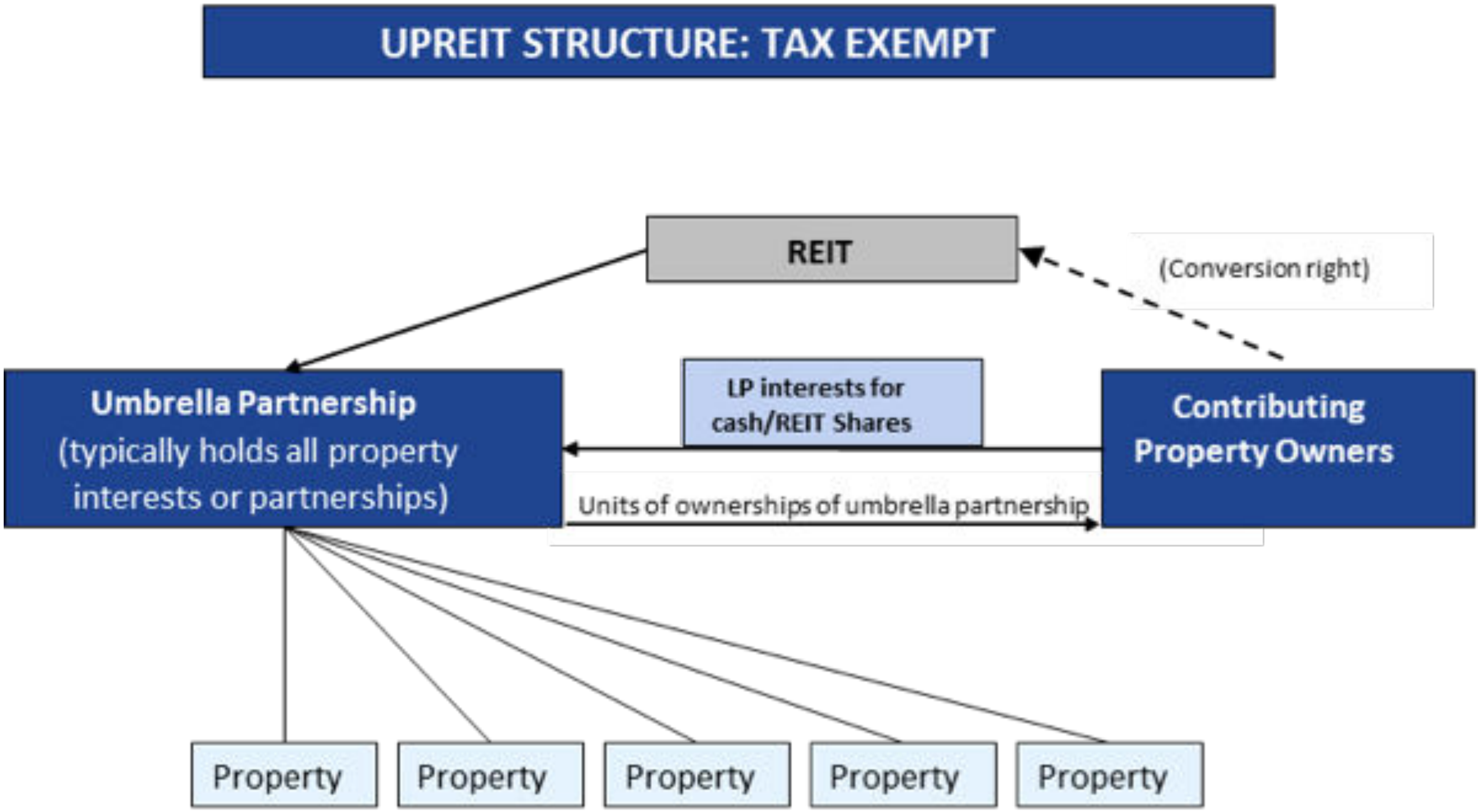
- **The decision to go public** depends on the desire to access large pools of anonymous capital, versus the willingness to adhere to the rules imposed on public companies.
- **What are these rules?**
  - They are many, including: reporting executive salaries; detailed audited financials; disclosing material information such as planned financings, developments, and major tenant lease expirations; describing material mistakes made in the course of business; and paying lawyers and accountants to create documents for the SEC.

Taxable REIT Subsidiary

REITs can offer ancillary services as long as they do not become the company's primary business, and as long as the REIT carves out the income from such services into a taxable subsidiary. Simply stated, "non-real estate" income cannot be sheltered from taxes by REIT status.

– For example, a REIT can offer dry cleaning pick-up services to tenants via its taxable REIT subsidiary.

UPREIT Structure



Summary

- The economic functions of secondary mortgage markets outweigh the risk.
- Three types of risks involved in MBS are the default risk, prepayment risk, and interest rate risk. The risks can be separately measured.
- CMBs tend to take the CMO or CDO structure with many rated tranches.
- Real estate private equity funds are relatively new forces in the commercial real estate market. Some private funds are no longer "private" but they still serve the same goals.
- REITs are the main sector of liquid real estate. They have been a stabilized industry since 1982. REITs provide public trading data to reflect the overall real estate market conditions.