How to Invest in REITs to Build Your Portfolio

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Want to invest in real estate but don't have the money to buy a property or have no desire to be a landlord? There is a way and it's called REIT investments.

Investing in a REIT, or a real estate investment trust is a way to own parts of a property without the traditional tasks of maintenance, taking rents or finding tenants.

A REIT involves buying shares of a fund and receiving part of the profits as passive income.

Many REITs are traded on major stock exchanges and can benefit investors in many ways.

"(Investing in REITs) takes away the headache and heartache of direct commercial real estate ownership," said Abby McCarthy, senior vice president of investment affairs for the National Association of Real Estate Investment Trusts — called Nareit — based in Washington, D.C.

REIT is an acronym for real estate investment trust, and you pronounce it as a word that rhymes with street or sweet.

What Is a REIT?

REIT — real estate investment trust — is a company that owns, operates or finances real estate in a variety of sectors that produce income. REITs are not necessarily real estate companies. Investors buy shares in commercial real estate portfolios through REITs.

"As the economy grows and changes, so do our needs for commercial real estate. The REIT industry is at the forefront of providing those types of real estate that help the economy," McCarthy said.

By investing, you give REIT companies money to buy more properties and in return, you get a portion of the rental income profits.

How Do REITs Work?

REITs pool the capital of all their investors and since they do not pay corporate taxes, they can usually pay for the real estate more cheaply than non-REITs. This is a good alternative to getting a share of property ownership when you don't have ample cash flow to invest on your own.

Shareholders buy shares in the REIT, much like buying shares of stocks. Then investors receive the profits in the form of periodic dividends, which are payments to shareholders drawn from profits.

So, let's say a REIT owns a bunch of properties, possibly including apartment complexes, industrial warehouses, and small office buildings. The organizations or people who either live or do business in those buildings have a lease and pay rent. So instead of one entity reaping all of the profits from that rental income, the REIT pays some of it out to its investors.

In general, REITs are liquid investments, meaning investors can get in and out of them fairly quickly and frequently. It's different from owning traditional real estate where an investor cannot usually decide to buy or unload a property and receive the money right away.

According to Nareit, as of November 2021:

- Approximately 145 million Americans live in the 43% of households that own REIT stocks in some way.
- REITs own approximately 503,000 properties across the country.
- REITs have $3.5 trillion in gross assets and distributed $89 billion in dividend income in 2020.
- There are currently 220 publicly traded REITs.
- Properties are located in all 50 states and in at least 40 countries.

How to Invest in a REIT

To invest in a REIT, you just buy a share in one just like you do any other stock. Like stocks, there are even REIT mutual funds and exchange-traded funds that include many REITs so you are investing in multiple REITs at once.

"It's as simple as opening a brokerage account or going into your IRA, doing the research on the REIT, and either sending an order to your financial advisor or clicking buy," said Ross Mayfield, an Investment Strategy Analyst for Baird.

A financial planner, investment advisor, or broker can help you decide how much of your investment dollars you might want to invest in REITs and into which one or ones.

For many REITs, there is no minimum investment amount, although private REITs often have a minimum.

"For one share, you just have to look at the share price of the REIT you'd like to buy. It's the same as buying a share of Apple. There might be a minimum to open an account or a minimum especially if you're going to pay a commission, but there is no structural minimum to buy a share of a REIT," he said.

Remember, through your 401(k) or other retirement plan, you might already be invested in REITs. Many pension plans are also invested in REITs. Check with your plan administrators.

To look for registered REITs, the Securities & Exchange Commission (SEC) has a helpful tool named EDGAR. Nareit also has a tool to look for information about REITs.

What Do REITs Own and Invest In?

A main feature of a REIT is they own and operate income-generating properties. The type of property they invest in varies.

The types of properties REITs invest in include but is not limited to:

- Offices: Could be buildings of various sizes ranging from professional centers to high-rises and everything in between.
- Retail and shopping centers
- Apartment buildings
- Warehouses
- Timberlands
- Self-storage buildings
- Medical and healthcare facilities: Can include hospitals, medical offices, labs, nursing facilities, retirement homes, etc.
- Cellular towers
- Infrastructure like fiber, cables, energy pipelines.
- Lodging, including hotels and resorts

"The common theme is that they all basically own structures or real estate that generate income in the form of rents and then that income is then paid out to shareholders in the form of dividends," McCarthy said.

Most REITs focus on a particular type of property, although some invest in a variety. That means there are office REITs, industrial REITs, retail REITs, lodging REITs, residential REITs, etc. You get the picture.

“The market has really shifted as the economy and e-commerce and technology have grown. The parts of the real estate market that house those pieces of the economy have grown with it.” McCarthy explained.

So places like data centers, logistics centers, cell phone towers, and warehouses have seen tremendous growth.

In 2000 the bulk of REITs were invested in residential, retail, industrial, and office, McCarthy said. Today, the biggest sector is cell towers.

Requirements to Be a REIT

The United States Congress established REITs in 1960 as an amendment to the Cigar Excise Tax Extension.

“It was meant to provide investors of all sizes access to the benefits of (owning real estate) which previous to REITs, only really wealthy individuals had,” McCarthy explained. “Those benefits include competitive investment returns, portfolio diversification, and strong income that real estate offers investors.”

According to Nareit, companies must meet many requirements to qualify as a REIT. The requirements include:

- Must meet certain provisions in the Internal Revenue Code (IRC).
- Must invest at least 75% of total assets in real estate, cash, or United States treasuries.
- Own income-generating real estate long term.
- Derive at least 75% of its gross income from rents from real property, interest on mortgages financing real property, or from sales of real estate.
- Pay at least 90% of its taxable income in the form of shareholder dividends each year.
- Be an entity that is taxable as a corporation.
- Be managed by a board of directors or trustees.
- Have a minimum of 100 shareholders.
- Have no more than 50% of its shares held by five or fewer individuals.

McCarthy said there are so many regulations because REITs are a function of the tax code and many of the rules have to do with how dividends are distributed and taxed.

Different Types of REITs

Just as there are different types of investors and real estate, there are different types of REITs.

Some are publicly traded and registered with the U.S. Securities and Exchange Commission (SEC) while others are private.

- **Equity REITs:** Equity REITs are the majority of REITs and are publicly traded and regulated by the SEC. Equity REITs own or operate income-producing real estate and generate income mostly through rents. The REIT operates a bit like a landlord, taking in rents and reinvesting that money into the property. Investors buy shares in equity REITs, often listed on major stock exchanges. Equity REITs are highly liquid. These are also known as Public REITs.
- **mREITs:** Mortgage REITs — called mREITs — provide financing for income-producing real estate by holding mortgages and mortgage-backed securities and earning income from the interest. Investors can buy shares in mREITs, often on major stock exchanges. This type of REIT is often a bit more risky than an equity REIT, but can pay higher dividends.
- **Hybrid REITs:** As the name implies, hybrid REITs invest in both equity and mortgage REITs.
- **PNLRs:** A PNLR is a Public non-listed REIT. This type of REIT is registered with the SEC, but does not trade on national stock exchanges. They operate similarly to publicly traded equity REITs but the frequency of liquidity varies.
- **Private REITs:** Private REITs or Private Placement REITs are not registered with the SEC and are not traded on national stock exchanges. Generally, only accredited investors (with a high net worth) or institutional investors like large pension funds can get into this type of REIT.

Many people are already investing in REITs and don't even realize it. Many 401(k) plans, pension plans, and other investment funds invest in REITs, including most target date funds where you choose the year closest to when you think you will retire.

Why Invest in a REIT?

Historically, REITs can be a way to create a balanced investment portfolio. They are traditionally less volatile than traditional stocks. McCarthy calls that a low correlation to the overall stock market because the returns are driven mostly by the real estate market and not the stock markets.

McCarthy said Nareit research shows portfolios that do the best have somewhere between 5% and 15% invested in REITs.

They offer competitive returns in the form of a steady income from dividends, however the amount of your initial investment, aka capital investment, might not grow much. This is because REITs can only reinvest 10% of their taxable income back into the REIT to buy new properties.

REITs periodically pay dividends to investors, which are often higher than stock dividends because of the requirement that REITs must distribute at least 90% of their taxable income to shareholders and they often have a stable stream of rents coming in.

The higher dividend income from REITs can be good for retirees and others who need an income stream to pay for living expenses.

“The income piece is probably the thing that attracts people the most,” Baird’s Mayfield said, adding many companies outside of REITs have either reduced or eliminated dividends.

In many cases, the dividend income from REITs is taxable as regular income, which will impact income taxes. This can be different from how many other stock dividends are taxed.

The fact that shares of REITs can be sold quickly and liquidated like common stocks is also a benefit to investing in a REIT compared to other types of real estate investments.

But be aware before making too many changes in your investment portfolio. Some REITs have high management and transaction fees, similar to other types of investments.

“You are paying managers to manage a portfolio of properties in the same way that in a mutual fund, you’re paying a manager to select stocks and manage position size,” Mayfield explained.

Also remember even though historically REITs have provided higher returns and have performed better than some other types of investments, they are not risk free.

Frequently Asked Questions (FAQs) About REITs

We have provided answers to some of the most commonly asked questions about real estate investment trusts.

What is a REIT?

REIT stands for real estate investment trust. REIT Investors buy shares in commercial real estate portfolios that own, operate, or finance real estate in a variety of income-producing sectors.

How Do I Start Investing in REITs?

To invest in a REIT, just open a brokerage account, research the REIT you want to buy, and either click buy or tell your financial advisor to do so.

How Much Money Do You Need to Invest in REITs?

There is no minimum to invest in most REITs. The price you invest depends on the share price of the REIT you are looking at. Some private REITS have investment minimums and only accept qualified investors with high net worth.

Can You Get Rich Investing in REITs?

REITs are long-term investments, so you could get rich and build wealth over the long haul. REITs can be a good way to replace paycheck income for retirees because they pay a steady dividend.

Is Investing in REITs a Good Idea?

As with any investment plan, good ideas are relative and depend on your situation. Nareit — the National Association of Real Estate Investment Trusts — recommends having about 5% to 15% of your investment portfolio invested in REITs. REITs can be a good and steady income stream.

Is My 401(k) Invested in REITs?

Many 401(k) and other retirement funds invest in REITs as a way to diversify their portfolios. If your retirement accounts are invested in a target date fund where you select the date closest to the date you wish to retire, chances are good you are invested in some REITs.

Tiffani Sherman is a Florida-based freelance reporter with more than 25 years of experience writing about finance, health, travel and other topics.