Learn benefits and drawbacks of Real Estate Investment Trusts and varieties

Q: I have read about REITs and they sound complicated. What do I need to know before I invest?

A: Real Estate Investment Trusts, or REITs, own or manage income-producing property. REITs provide investors access to real estate without the hassle of direct ownership. Think office buildings, shopping malls, apartments, and hotels.

There are different types of REITs. Some are publicly traded (like stocks) and prices are available daily. REITs are like any other investment and market prices vary with time based on supply and demand. Aren't we glad that our home values were not published daily after the real estate crash?

Investment risks of REITs are directly related to the type of real estate held and the quality of the management. The prospectus describes the offering, history of the business, investment objective, management team, fees, selling restrictions, dividends and distributions, and debt limits.

Non-traded REITs are not traded on exchanges and often are illiquid. Liquidity risk is the lack of marketability of an investment that cannot be bought or sold easily. Since non-traded REITs aren't listed on securities exchanges, they can be difficult to price which explains why custodians charge around $250 per year just to hold these 'non-standard' assets.

Non-traded REITs frequently pay distributions that exceed earnings from operations; this reduces the value of the shares.

Most issuing companies of non-traded REITS have limited share redemption programs. Investors may be disappointed when their redemption price is less than their original purchase price. After a number of years, most non-traded REITs have a set date to be listed on a securities exchange or be liquidated.

Due to consumer complaints, the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) have issued 'investor alerts' on non-traded REITs. The front-end fees are limited to 15% of the share price. Selling commissions cannot exceed 10% of the investment.

Interest rates are at historical lows and investors are looking for income alternatives. Analyze the investment and withdrawal restrictions. Determine whether a real estate investment is right for you and how it fits into your financial plan.

As always, talk to your advisors.

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