Principles by IUCG:

Navigating the Real Estate Investment Industry

OVERVIEW

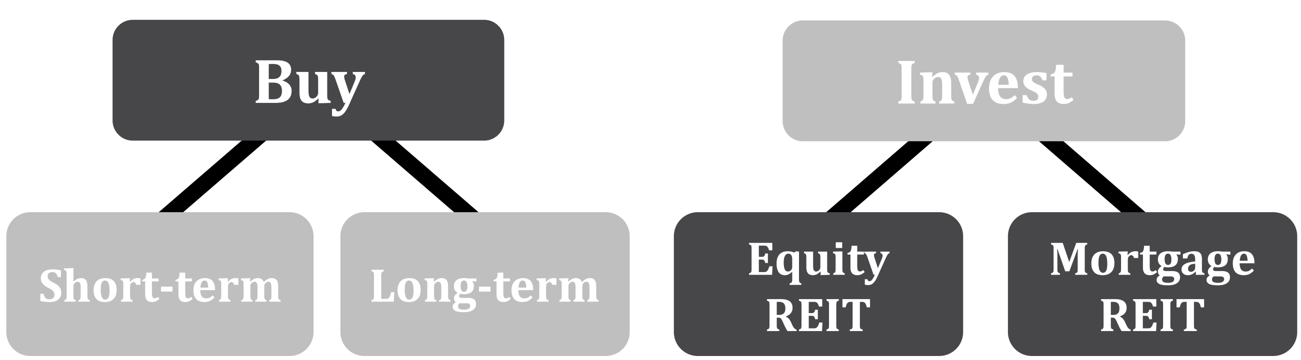
There is a lot more to real estate than just buying a home. For investors looking for a source of additional income, real estate allows individuals to diversify their portfolios without pursuing standard secondary market options. Investment vehicles unique to the real estate industry allow investors to prepare for the future in exciting new ways.

What is Rental Property?

Rental property derives more than 80% of its revenue from dwelling units. The basis of all rental income includes two parties: landlords and tenants. The landlord is the owner of the property and rents out the land to a tenant. Each party has certain responsibilities. The landlord is responsible for paying the mortgage, the taxes, and any other general maintenance fees associated with the property. On the other hand, the tenant is responsible for paying rental fees to the landlord as well as taking adequate care of the property.

Real Estate Opportunities

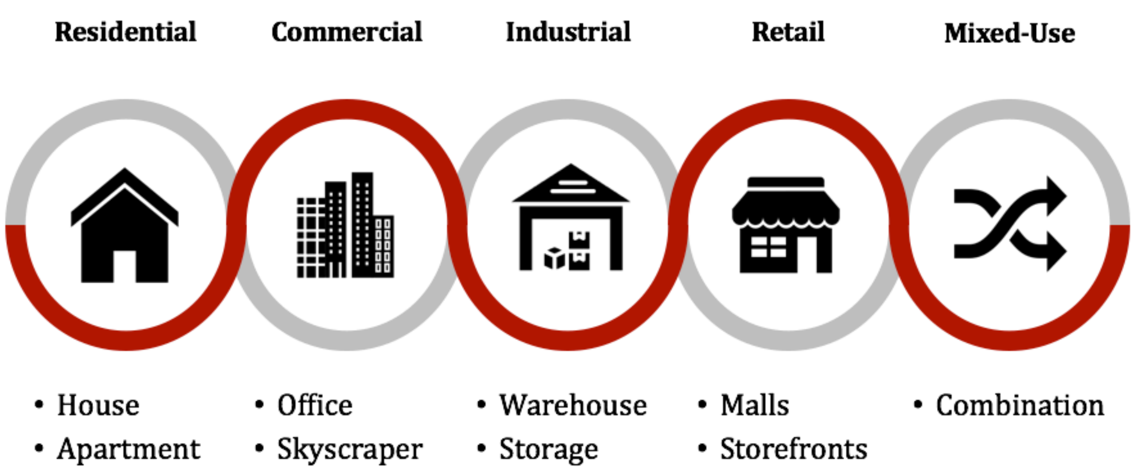
Real estate has two primary components: buying property and investing in real estate investment firms. Buying property encompasses short-term vs. long term investments while investing in real estate firms functions similarly to the stock market. Rather than purchasing land, money is invested into a company with the expectation of receiving higher returns. The most popular form of real estate investment is through real estate investment trusts, or REITs for short. Within real estate investment trusts, there are two types of investments: equity and mortgage.



BUYING PROPERTY

Real Estate Trading

Short term investing is also known as **real estate trading**, or "flipping". Flipping is a real estate investment strategy in which an investor purchases a property with the intention of selling it for a profit. The typical window for resale is three to four months. Key items to look for when purchasing a property to flip is either a significantly undervalued property, or one that is in a hot area. Long-term investments, on the other hand, are focused primarily on renting the property for rental income. The main types of rental property are found below.



Important Considerations

1. **Location**
    A. Select a region to invest in (example: The Southeast)
    B. Consider the location's proximity to major cities and attractions as these have the potential to draw large populations to the area
2. **Unemployment Rates**
    A. It is important to buy rental property in an area with low unemployment.
    B. Low unemployment helps to ensure that tenants will pay their rents and that people will move in if there are vacancies.

3. **Vacancy Rates**
    A. Buying property in areas with low vacancy rates is imperative
    B. High vacancy rates are indicative of areas that are not in high demand
4. **Rental Rates**
    A. Rental rates determine the profits to be made through rent
    B. Immediate growth opportunities reside in properties with rental rates below regional average
5. **Tenants**
    A. Maintain tenants who will pay their rents and take adequate care of the property

How do Investors Make Money?

There are three primary ways in which real estate investors make money.

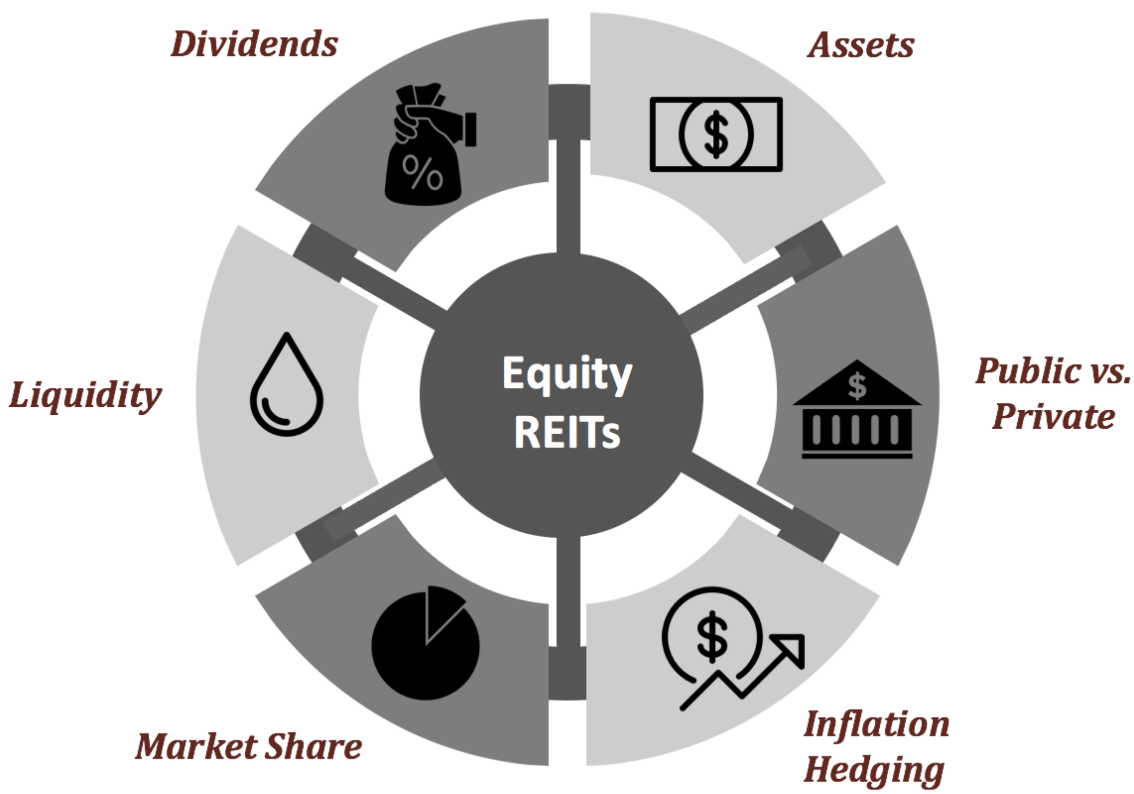
1. **Real Estate Appreciation**
    A. Real estate appreciation stems from an increase in property value.
    B. Increases are created by a change in the market in which a new demand for a specific type of property arises
    C. Upgrades added to a property can increase interest from potential investors
2. **Cash Flow Income**
    A. Cash flow income is generated through buying and operating property and generates the most profit for an investor
    B. Owner generates cash by renting out property space to buyers
    C. Types of cash-flow income properties include storage units, car washes, apartment buildings, office buildings, and rental houses
3. **Ancillary Revenue**
    A. Revenue generated from goods or services that differ or enhance the main services of a company
    B. A main type of ancillary investment is through vending machines, which can be a huge source of profit within a building

REAL ESTATE INVESTMENT TRUSTS

Equity REITs

Equity REITs make up 70% of real estate investment trusts and 90% of the REIT industry equity. The industry maintains over 50,000 properties and possesses over $1 trillion in real estate assets. Legally, equity REITs are forced to pay off 90% of their annual taxable income in the form of dividends. On average, these dividend returns are higher than dividends received through the S&P 500. Equity REITs also function similarly to the stock market. There are over 170 equity REITs on the NYSE. Therefore, this form of investment acts as a highly liquid asset with the ability to buy and sell on the NYSE.

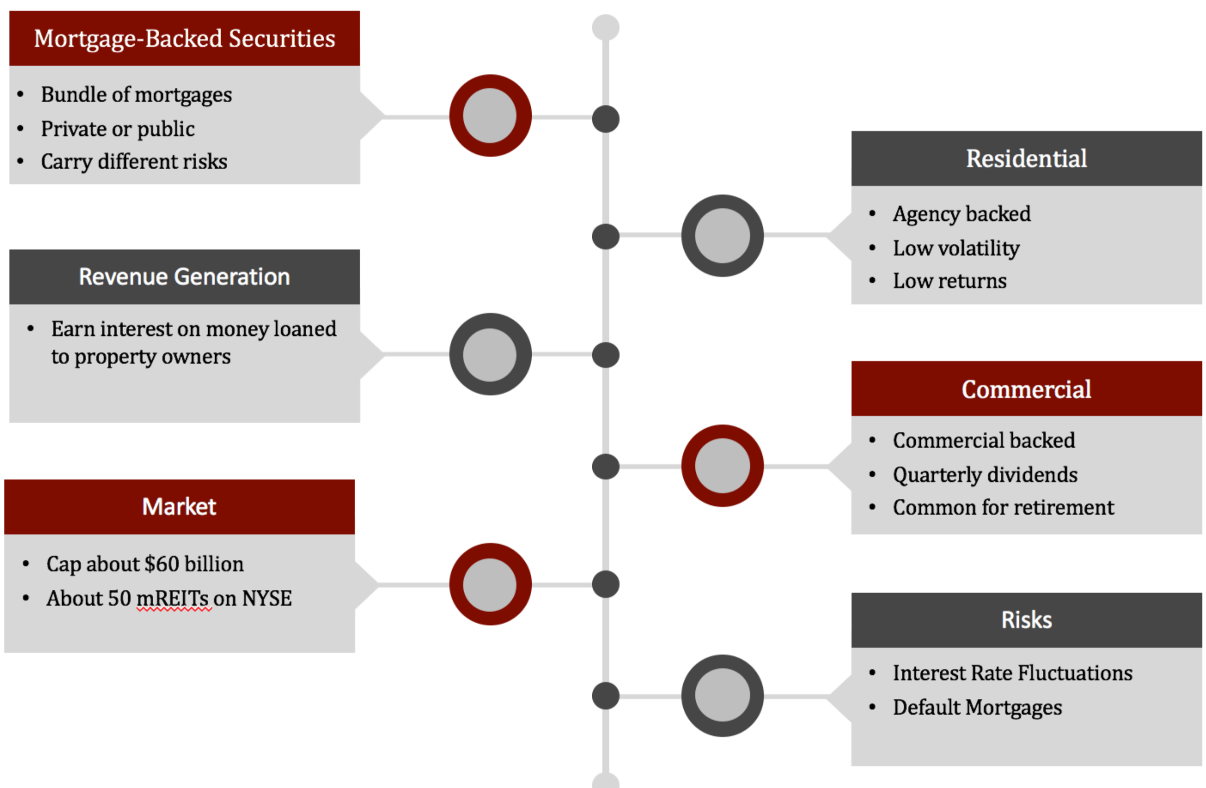
Characteristics of Equity REITs



Mortgage REITs

Mortgage REITs, or mREITs make up the other 30% of REITs. mREITs companies lend money to real estate buyers or acquire mortgages or mortgage-backed securities. Mortgage-backed securities are bundles of mortgages that are grouped together and sold at different prices based on risk. They generate revenues from interest earned on mortgage loans. There are two different types of mortgage REITs: residential and commercial. Residential REITs are most often agency-backed securities facilitated through companies like Fanny Mae and Freddy Mac. The market has low volatility, but also low returns. On the other hand, commercial REITs focus on commercial mortgages and commercial-backed securities. They often pay out quarterly dividends to their shareholders.

Characteristics of Mortgage REITs



CONCLUSION

Real estate is an effective way to diversify a portfolio outside of stocks and bonds. Physical real estate provides a tangible asset as well as monthly income in the form of tenant rent. However, there are more costs and headaches that come with operating a building or home. Real estate investment trusts are a cheaper way to invest in real estate without investing in physical property. It is a highly liquid asset, similar to a stock, and receives consistent dividends. On the downside, REITs have higher volatility, and, similar to stocks, are risky. Whether it is buying property or investing in REITs, real estate allows individuals to capitalize on unique market opportunities that can only be found when investing in physical assets or their overlying counterparts.

Purchasing Real Estate Pros and Cons

Pros

- Tangible asset
- Importance of owning a home – American dream
- Safer leveraging

Cons

- Hands on work
- Monthly costs
- Average return is less than stocks (after inflation)

Real Estate Investment Trusts Pros and Cons

Pros

- Cheaper than physical real estate
- Liquid asset – easy to buy and sell
- Consistent cash flows (dividends)
- Portfolio diversification

Cons

- Higher volatility than physical real estate
- Limited tax breaks
- Buying property at retail prices