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REAL ESTATE INVESTMENT TRUSTS (REITs)

Real estate investment trusts are of either one or a combination of two types - mortgage trusts or equity trusts. As their names imply, mortgage trusts invest in real estate mortgages and have as their primary objective current income, while equity trusts own their properties outright and seek to participate in any appreciation in their value, as well as their current income.

For a number of reasons, we do not encourage the ownership of real estate investment trusts:

(1) Investors who own their own home may already have a high percentage of their net worth committed to real estate. From the point of view of diversification, then, increasing one's concentration in real estate still further may not be prudent.

If the investor has a second home and any other real estate, the case against his owning REITs is stronger; and, if he has a mortgage on any of his real estate, his ownership of this asset is leveraged, and so the case against adding to the sector is stronger still.

(2) Investors who have common stock portfolios invested in other-than-REITs already have substantial positions in real estate. It is estimated that 25% of all corporate net worth is its real estate.

(3) An article in the Spring 1994 publication of Real Estate Finance entitled "Long-Term Return Characteristics of Income-Producing Real Estate" reports on a study of all qualified REITs traded on the New York, American, and NASDAQ markets with return information covering the three decades between 1962 and 1993.

During the 1962-93 period, equity REITs had an average compound total return of 10.2% per year, as compared with 11.0% for the Standard & Poor's 500 and 15.1% for small-capitalization companies. Though less volatile than small-company returns, equity REIT returns were more volatile than the S&P 500. Most REITs have historically been small-capitalization firms.

On the basis of investor experience of the past thirty years, then, it appears that, as an investment, real estate has delivered total returns somewhat less than the returns on common stocks. In particular, REITs, which tend to be smaller (and riskier) than the companies that comprise the Standard & Poor's 500 have been more volatile and have delivered a lower return than the stocks in that index.

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1998