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DFR-Securities Division

Human Services Committee—Summary of REIT overview testimony

- A REIT is a corporation, trust, or unincorporated association that elects to be treated as a Real Estate Investment Trust (REIT) under federal tax law. Most REITs are formed as corporations. REITs may not be closely held; they must have at least 100 shareholders to qualify under the Internal Revenue Code.

- A REIT's usual purpose is to use investment capital to acquire, manage, and generate an investment return on income-producing property. REITs buy, sell, own and operate many types of real estate. They often focus on investing in a specific industry, including but not limited to shopping malls, office buildings and office parks, residential apartment buildings, and medical facilities.

- Some REITs offer their shares on public stock markets, others issue shares only through networks of broker dealers ("non-traded" REITs).

- REITs may sound like a niche financial product, but as reported by NAREIT, the REIT industry trade association, they own approximately $3 trillion in assets nationwide. Shares in REITs are owned by an estimated 70 million Americans, either directly or through retirement funds and other similar investment funds. There are approximately 1,100 entities that have elected to be treated as REITs by the IRS. Roughly 225 of these are publicly traded.

- Entities that qualify as REITs can deduct distributions to shareholders from their federal income taxes, and the Internal Revenue Code requires REITs to distribute at least 90% of their income to shareholders each year. This makes them similar to pass-through entities like S-corporations, even if they are not true pass-throughs.

- State regulation of exchange-traded REITs is largely preempted by the National Securities Markets Improvement Act of 1996. Non-traded REITs are required to register with state securities regulators. State securities regulators monitor the broker-dealers and investment advisors involved with the marketing of both kinds of REITs. Aside from the issue of fraudulent representations to investors regarding the scale, value, and potential profitability of a REIT's asset holdings, state and federal securities regulators have no jurisdiction over, and fairly little knowledge of, what REITs do with the commercial properties they acquire and operate as going concerns.

- The market for REIT shares is very competitive, and the pressure to produce a return for shareholders (usually including REIT management) will be the principle concern of any REIT manager. If a REIT and its management are affiliated with other corporate entities that run businesses on the REIT-owned property, the imperative to generate a return for REIT shareholders may influence the management of those businesses as well. The imperative to generate a return may also incentivize liquidating properties in certain circumstances regardless of any larger public policy concerns.

- REITs usually function as “blind pools,” meaning non-managerial investors have very limited rights regarding how the REIT’s capital will be used and how its assets will be managed.