



# Masterclass on Real Estate Income Trusts (REITs)

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## Introduction - Chapter 1

Venue:

Osher Lifelong Learning Institute  
U of M St. Paul Campus, Magrath Library

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# Course Outline

## Contents

### 0. Course Outline & Disclosures

### 1. Introduction to REITS

### 2. REIT Market Overview

### 3. REIT Credit Ratings

### 4. REIT Valuations – Macro & Price Forecasting

### 5. REIT Valuations – Company & Target Price Projections

### 6. REIT Screening Process

### 7. REIT Performance Metrics

# Disclosures

## Purpose

Course discussion material is intended for general financial education only. Class discussion seeks to confirm and challenge your understanding of how financial markets work. Course material has not been prepared as investment, tax, or legal advice, nor is it a solicitation to buy or sell any securities. Course attendees are informed that:

- **Investing in REITs involves the risk of loss. REITs are distinguished by type, industry sector, and credit quality. Some REITs are riskier than others.**
- **Potential market price risks in REIT investing are caused by variations in interest rates, national demographics, local real estate markets and climate.**
- **Detailed due diligence is required to understand any REIT or real estate specialization. Investors are encouraged to read trust company reports filed quarterly and annually with the SEC and stored in the SEC's Edgar System.**
- **Non-traded REITs are not listed on an exchange. Non-listed REITs have high commission fees on investment entry. They may also have inflexible and minimum holding periods (e.g. 10 years). Non-listed REITs can also have high operating costs, high management fees, no independent valuation data, and liquidity risks that complicate investment exits or redemptions.**
- **Be wary of persons who sell REITs that are not registered with the SEC. You can verify the registration of publicly traded and non-traded REITs through the SEC's EDGAR system.**

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Part 1

# Introduction to REITs

**Standard Definitions  
and  
Operating Structures**

# Why Do REITs Matter?

## REITS are one of many building blocks for retirement income

### Financial Assets

- Pension plan distribution strategies
- Social Security claiming strategies
- Employer-sponsored retirement plans
- IRA, Roth IRAs, and SEP investment accounts
- Taxable investment accounts

### Real and Alternative Assets

- **Real estate rental income**
- **Real estate capital gains**
- **Structured investment vehicles (REITS)**
- Infrastructure Projects
- Farm, mineral, and forest income
- Private equity and business cash flows
- Home equity

### Contract Assets

- Royalty income
- Annuity and insurance cash flows
- Estate tax plans, trusts, and inheritance

### State and Federal Government

- Standard and non-standard assistance programs



# Why Do REITs Matter?

## S&P500 Index Real Estate Sector (XLRE)

Ticker	Name	Industry	Sub-Industry	Share
PLD	Prologis	Industrial REITs	Industrial REITs	10.5%
AMT	American Tower	Specialized REITs	Telecom Tower REITs	9.4%
EQIX	Equinix	Specialized REITs	Data Center REITs	6.9%
WELL	Welltower	Health Care REITs	Health Care REITs	6.6%
PSA	Public Storage	Specialized REITs	Self-Storage REITs	5.3%
SPG	Simon Property Group	Retail REITs	Retail REITs	4.9%
O	Realty Income	Retail REITs	Retail REITs	4.8%
CCI	Crown Castle	Specialized REITs	Telecom Tower REITs	4.4%
DLR	Digital Realty	Specialized REITs	Data Center REITs	4.2%
EXR	Extra Space Storage	Specialized REITs	Self-Storage REITs	3.3%
CBRE	CBRE Group	RE Mgmt & Dev	Real Estate Services	3.2%
VICI	Vici Properties	Hotel & Resort REITs	Hotel & Resort REITs	3.1%
IRM	Iron Mountain	Specialized REITs	Other Specialized REITs	2.9%
AVB	AvalonBay Comm.	Residential REITs	Multi-Family Residential REITs	2.8%
CSGP	CoStar Group	RE Mgmt & Dev	Real Estate Services	2.8%
EQR	Equity Residential	Residential REITs	Multi-Family Residential REITs	2.5%
VTR	Ventas	Health Care REITs	Health Care REITs	2.3%
SBAC	SBA Communications	Specialized REITs	Telecom Tower REITs	2.2%
INVH	Invitation Homes	Residential REITs	Single-Family Residential REITs	2.0%
WY	Weyerhaeuser	Specialized REITs	Timber REITs	2.0%
ARE	Alexandria Real Estate	Office REITs	Office REITs	1.9%
ESS	Essex Property Trust	Residential REITs	Multi-Family Residential REITs	1.7%
MAA	Mid-America Apartments	Residential REITs	Multi-Family Residential REITs	1.7%
KIM	Kimco Realty	Retail REITs	Retail REITs	1.4%
UDR	UDR, Inc.	Residential REITs	Multi-Family Residential REITs	1.3%
CPT	Camden Property Trust	Residential REITs	Multi-Family Residential REITs	1.2%
REG	Regency Centers	Retail REITs	Retail REITs	1.2%
HST	Host Hotels & Resorts	Hotel & Resort REITs	Hotel & Resort REITs	1.1%
BXP	BXP, Inc.	Office REITs	Office REITs	1.0%
FRT	Federal Realty	Retail REITs	Retail REITs	0.9%
DOC	Healthpeak	Health Care REITs	Health Care REITs	0.5%

Many of you already  
own REITs

### S&P 500 Large-Cap Index

Sector	Share
Information Technology	31.0%
Health Care	12.2%
Financials	11.8%
Consumer Discretionary	10.0%
Communication Services	9.8%
Industrials	8.3%
Consumer Staples	6.6%
Energy	3.4%
Utilities	2.4%
<b>Real Estate</b>	<b>2.3%</b>
Materials	2.2%
<hr/>	
	100.0%



# REITs Defined

A REIT is a trust company that owns and operates income-producing real estate or related assets, including:

- Physical real estate assets,
- Real estate debt.

REITs allow individuals to invest in large-scale, income-producing real estate without direct management responsibility.

## Buy – Own – Operate

- A REIT buys and develops properties primarily to operate them as part of its own investment portfolio.
- The goal is reliable, long-term income generation for investors.

## Develop-Flip

- REITs typically do not develop properties to resell them.
- A REIT forms strategic partnerships with property owners and developers who sell them properties to fill their transaction pipeline and portfolio.
  - Exception: Large trust companies have internal subsidiaries to develop properties to flip into a REIT



# Pros and Cons of REIT Investing

## BENEFITS

- Access to real estate
- Regular income
- Professional management
- No income taxes at the corporate level
- Pooled funds for increased buying power
- Diversification vs. stocks and bonds
- Hedge against inflation
- Liquidity
- Simplicity

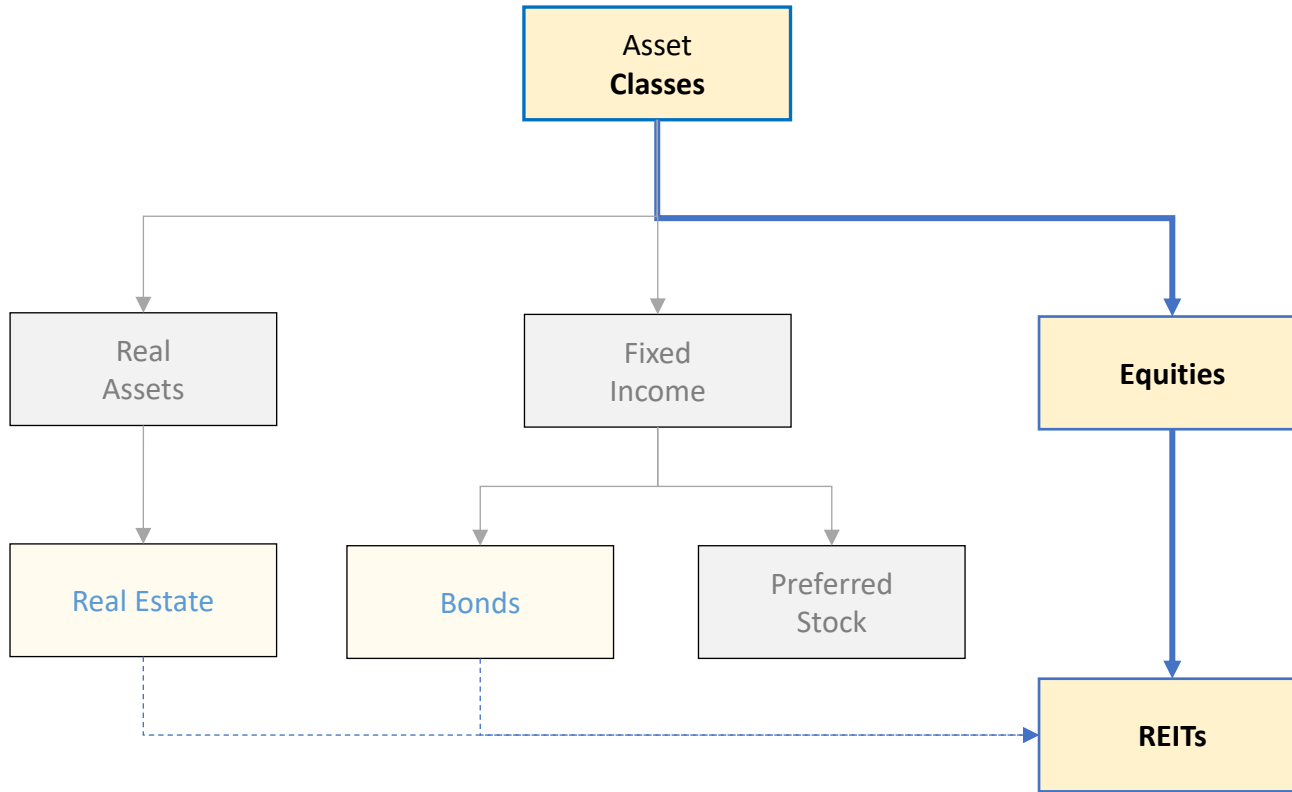
## DRAWBACKS

- Impact of higher income on tax strategy
- Business cycle interest rate risk
- Need to diversify trust company concentration risk
- Catastrophe risks (floods, fire, wind, etc.)





# REITS: Which Asset Class?



REITs have a unique risk-return profile

Variable income-generation

+

Capital gains from the real estate and stock markets

## REITs as Hybrid Securities

REITs are equities since investors own common shares in a trust that owns and operates real estate.

Investors in REITs have a claim on the free cash flow of the trust company, but no direct claim on the physical real estate if the trust goes bankrupt.

REITs share traits with bonds. Depending on the tax jurisdiction, REITs must distribute 70-90% of their taxable income as dividends.

Structured REITs are also classified as an alternative investment in real assets, like infrastructure projects, commodities, and private equity.

# REIT Trust Companies vs Corporations

	REIT Trust Companies	Corporations
Purpose	Manages assets for profit for beneficiaries.	Operates a franchise for profit for shareholders.
Legal Structure	Governed by a trust agreement to enable trustees to manage assets.  Trustees have a fiduciary duty to act in the clients' best interests.	An independent legal entity separate from its owners.  Profit maximization without a fiduciary obligation.
Ownership	Net assets are owned by the Trust. The '5/50 rule' limits ownership concentration	Net assets are owned by shareholders. Ownership concentration allowed, but disclosed
Governance	Managed by Trustees according to the Trust agreement.	Managed by board of directors according to corporate bylaws.
Regulation	State and federal laws to ensure transparency and fiduciary standards, plus securities regulations if publicly traded.	State and federal corporate law depending on industry, plus securities regulations if publicly traded.
Taxation	Income is NOT taxed at the trust level, but the beneficiary level	Taxed at the corporate level as a separate entity, exposing investors to double taxation of earnings and dividends.
Duration	Typically have a fixed duration subject to periodic renewal.	Indefinite subject to periodic registrations.
Liability	Trustees have a fiduciary duty but limited liability. The trust is liable for corporate debts and other risks	Officers and shareholder have limited liability. The company is liable for corporate debt and other risks
Profit distributions	Per the terms of the trust and tax regulations High dividends + limited share buybacks	No distribution requirements Low dividends + large share buybacks

# REIT Trust Companies

## Tax Status and Compliance

The Internal Revenue Code treats REITs as ‘pass-through entities’ with no taxes at the corporate level. This exception does not come free.

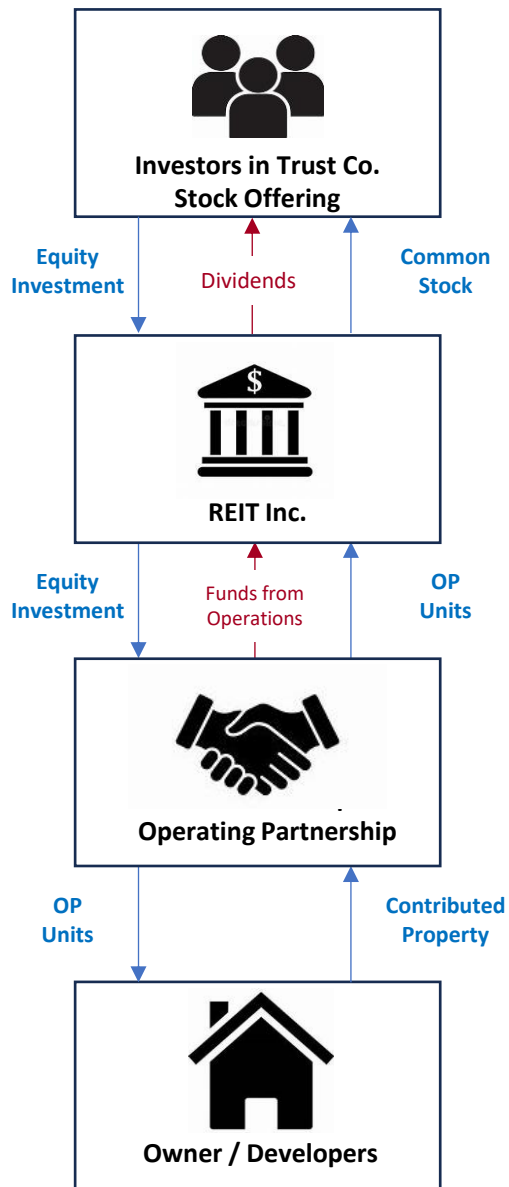
### The 75-75-90 Rule

- **Income sources:** 75% of the REIT’s annual gross income must come from real-estate activities.
  - Rental income, interest on mortgages, gains from property sales, property management fees, dividends from other REITs
  - 95% of gross income must come from passive real estate sources. REITs cannot engage in frequent buying and selling of properties. Note: The 5% exception rewards scale or large-cap REITs.
- **Use of funds:** 75% of a REIT’s assets must be invested in real estate.
- **Distributions:** 90% of a REIT’s taxable income (excluding capital gains) must be distributed to shareholders annually.

Noncompliance can result in a REIT losing its tax-advantaged status and being taxed as a corporation



# REIT Stakeholder Mapping



## Investors

REIT investors receive common stock in the publicly traded REIT but do not directly own properties.

Shareholders receive stock dividends based on the income generated by properties held in an operating partnership.

## Trust Company

The REIT owns a significant interest in the Operating Partnership and typically serves as the General Partner (GP).

The REIT manages the day-to-day operations and strategic direction of the properties held by the OP. In exchange, the REIT receives management fees

## Operating Partnership

The OP is the entity that directly owns the properties within the REIT (e.g. UPREIT structure). The OP is typically set up as a limited partnership or limited liability company.

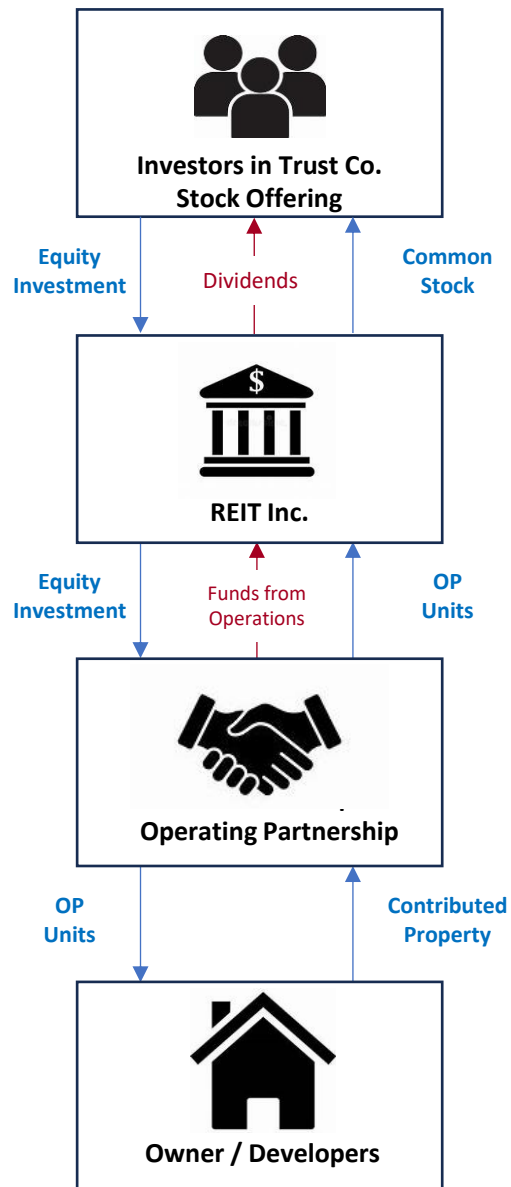
## Property Owners and Developers

Owners contribute real estate to the OP in exchange for OP Units. Owners are the Limited Partners (LPs).

OP units typically convert to REIT common stock after 1 year, providing profit sharing and alignment of incentives.

LPs do not have control over the management of the OP.

# REIT Stakeholder Benefits & Risks



## Investors

Investors gain access to real estate income + capital gains  
Investors benefit from the management expertise of the general partner.

Investors subject to strategic portfolio, management, and balance sheet risks

## The Trust Company

The General Partner is allowed to deduct fees from the OP cash flows (e.g. funds from operations).

The requirements to pay 70-90% of all funds from operations can result in liquidity shortages.

Growth dependent on GP strategic capital sources, debt funding capabilities, competitive deal pipeline, and long sales cycles.

## Property Owners / Developers

Property owners receive OP Units, not cash, for property sales.

The Op Units convert to REIT shares after 1 year, transforming exposure from a single property to a diversified portfolio. This may be strategically beneficial, but also represents dilution of ownership.

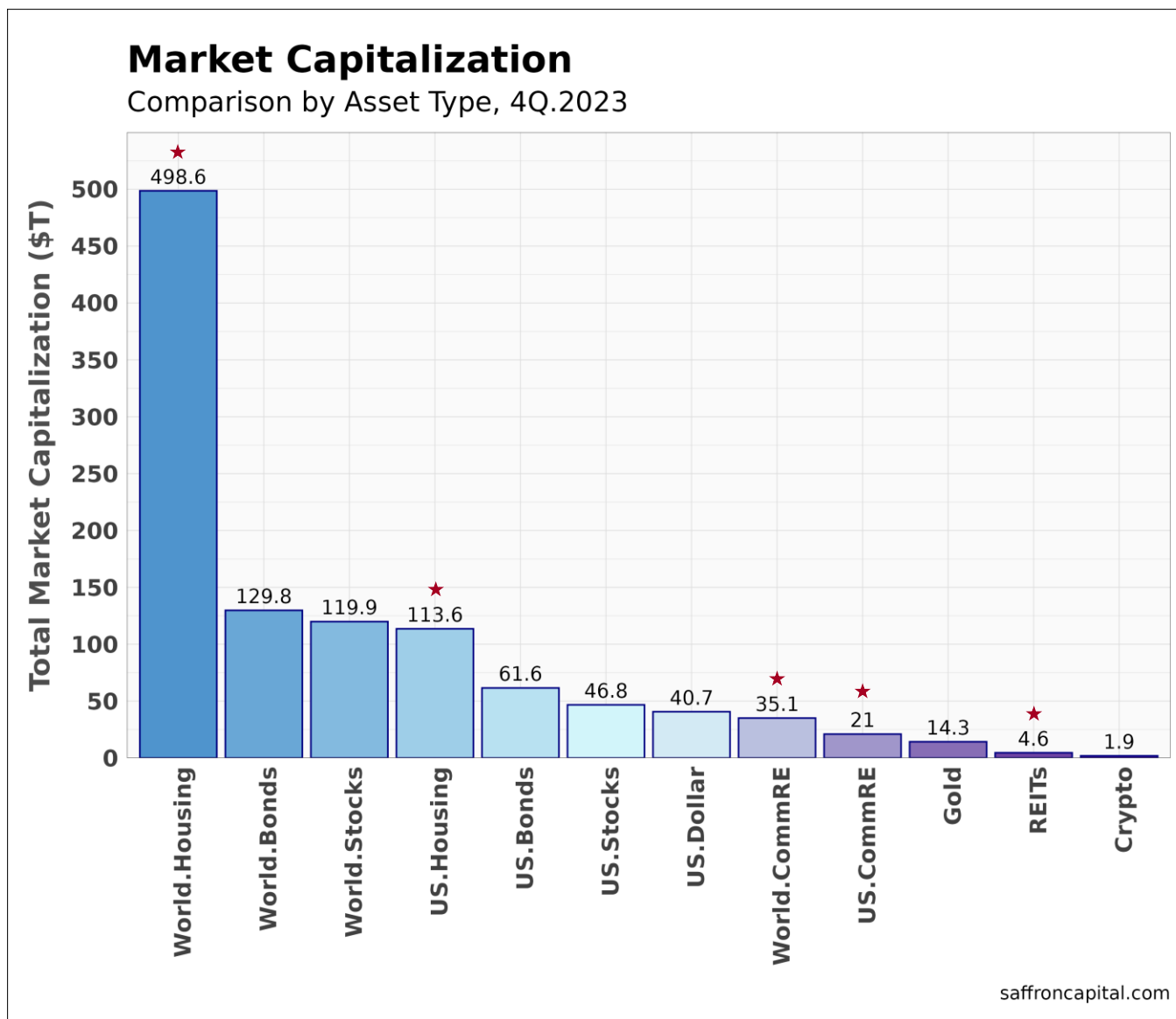
REITs provide liquidity and timing flexibility for when to sell the REITs for cash. Capital gains can be deferred, but not eliminated.

Part 2

# REIT Market Overview



# Asset Class Benchmarking



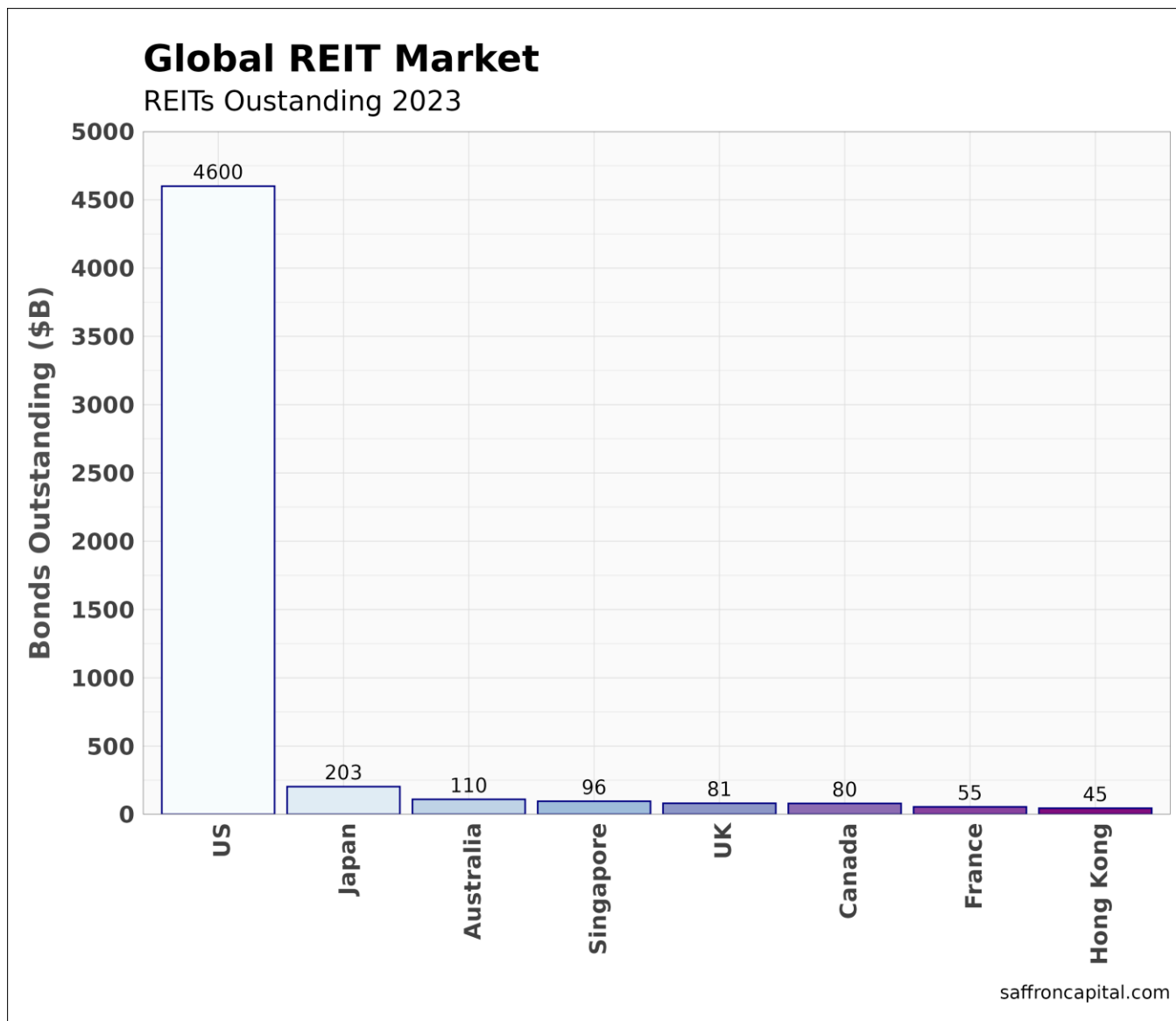
The physical real estate markets dwarf traditional bond and stock markets, as shown by the market cap of global housing.

The US housing market is estimated to have a market capitalization of \$113.6 trillion, while the US commercial real estate market has a market cap of \$21 trillion.

In comparison, the US REIT market has a total market cap of \$4.6 trillion.

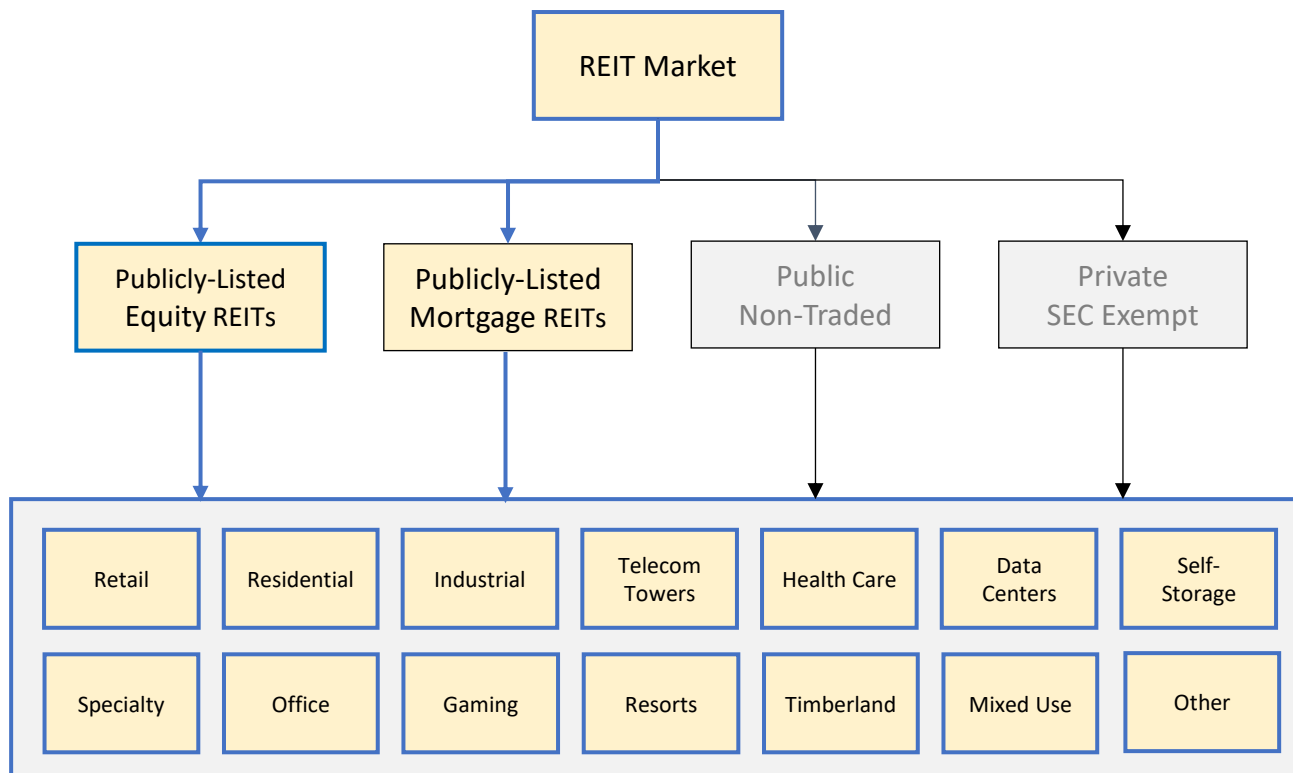
US-listed equity REITs:  
**\$1.4 trillion**

# Capital Market Benchmarking



The US REIT market is over 20 times larger than the nearest international market.

# REIT Market Structure and Sectors



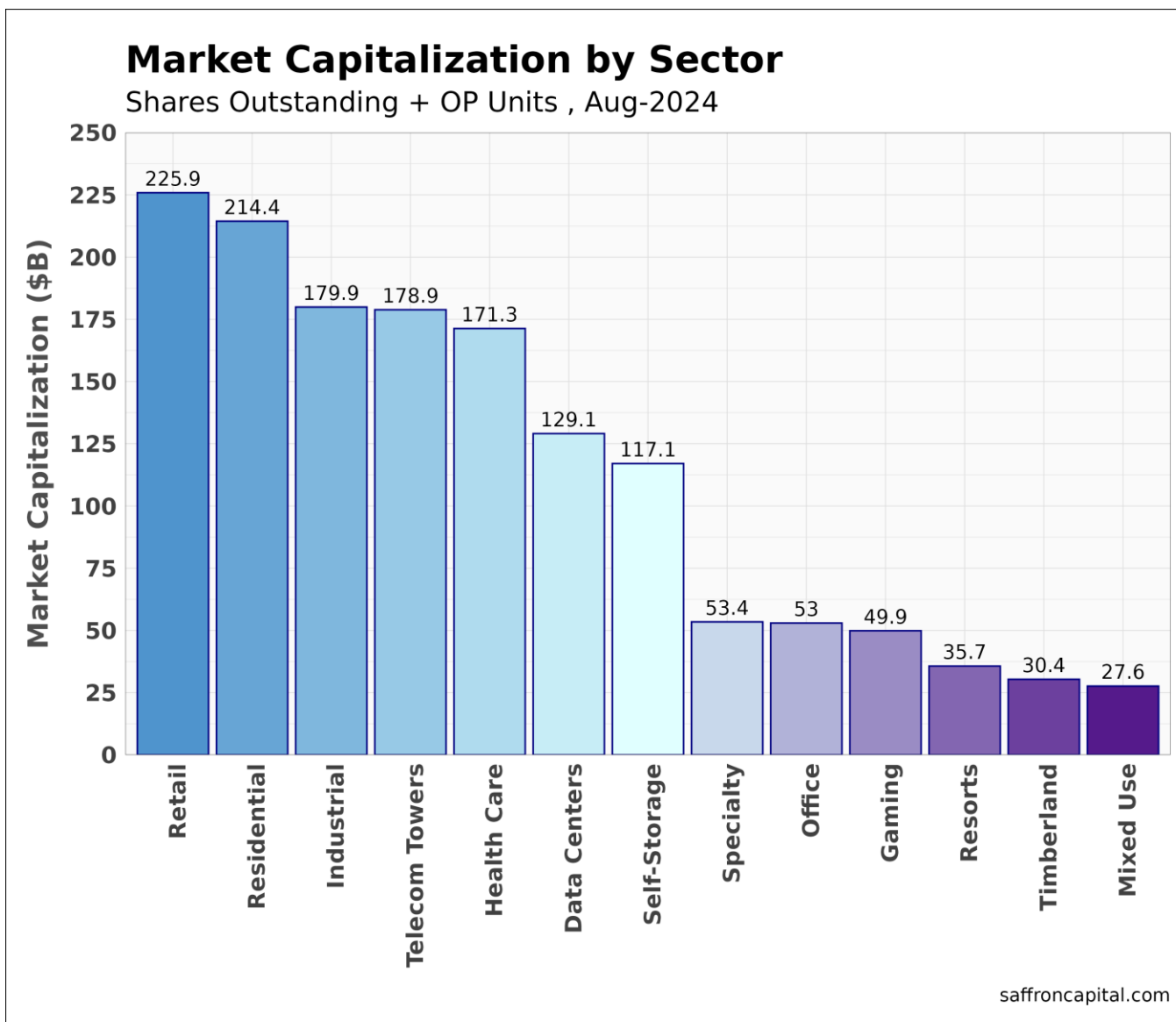
## Market Capitalization

Public Equity	\$1.4 T
Public Non-Traded:	\$0.3T
Private:	\$2.2 T
Mortgage	<u>\$0.7 T</u>
Total	\$4.6 T

## REITs have broad popularity:

- 170 million Americans (or ~ 45%) have investments in REITs

# Equity REITs - Market Structure



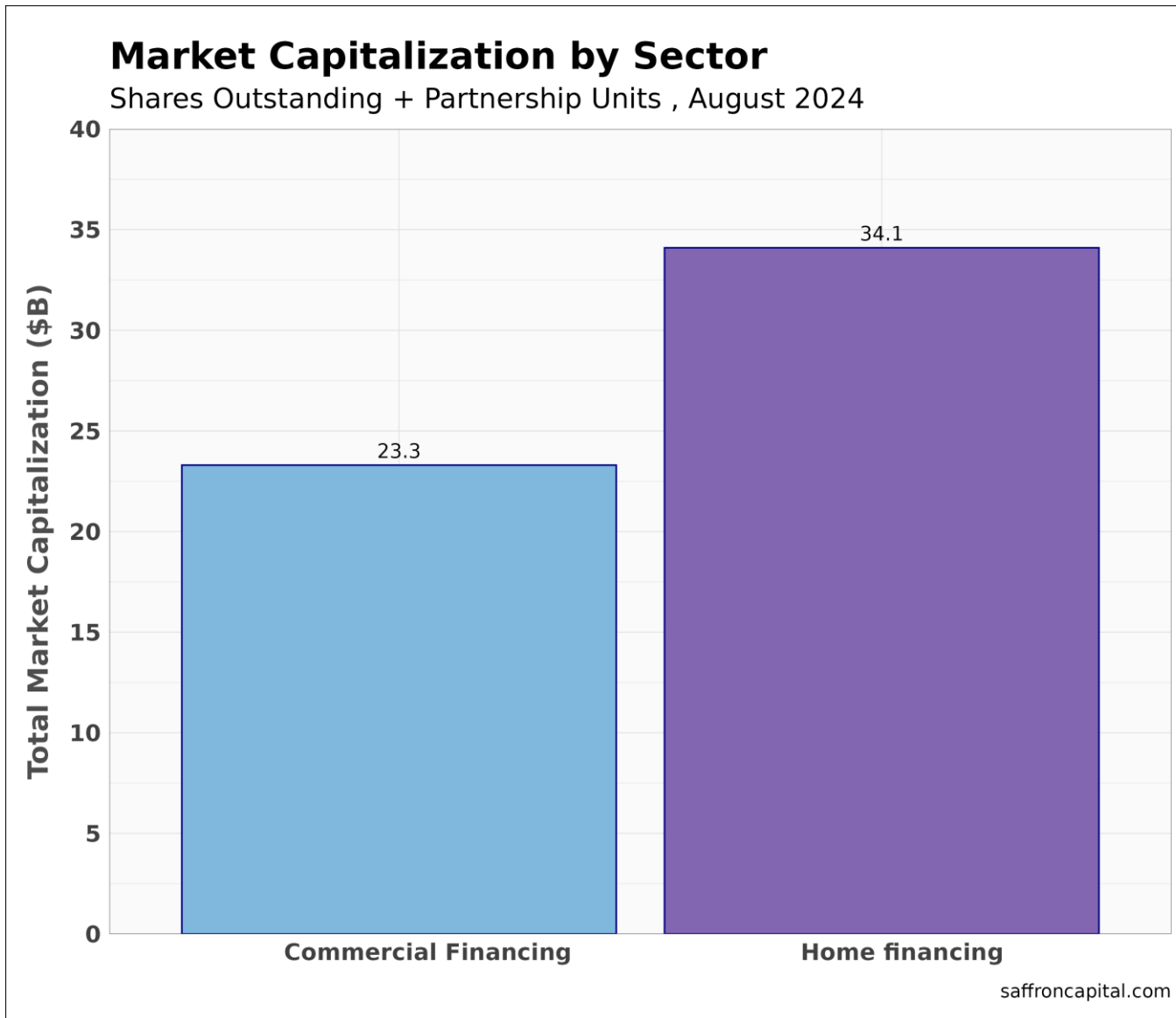
The large Retail sector has several sub sectors:

- Shopping centers \$77B
- Regional malls \$67B
- Free standing \$81B

The large Residential sector also has sub sectors:

- Apartments \$142B
- Manufactured homes \$33B
- Single family homes \$39B

# Mortgage REITs – Market Structure



The REIT mortgage market is significantly smaller than the REIT equity market.

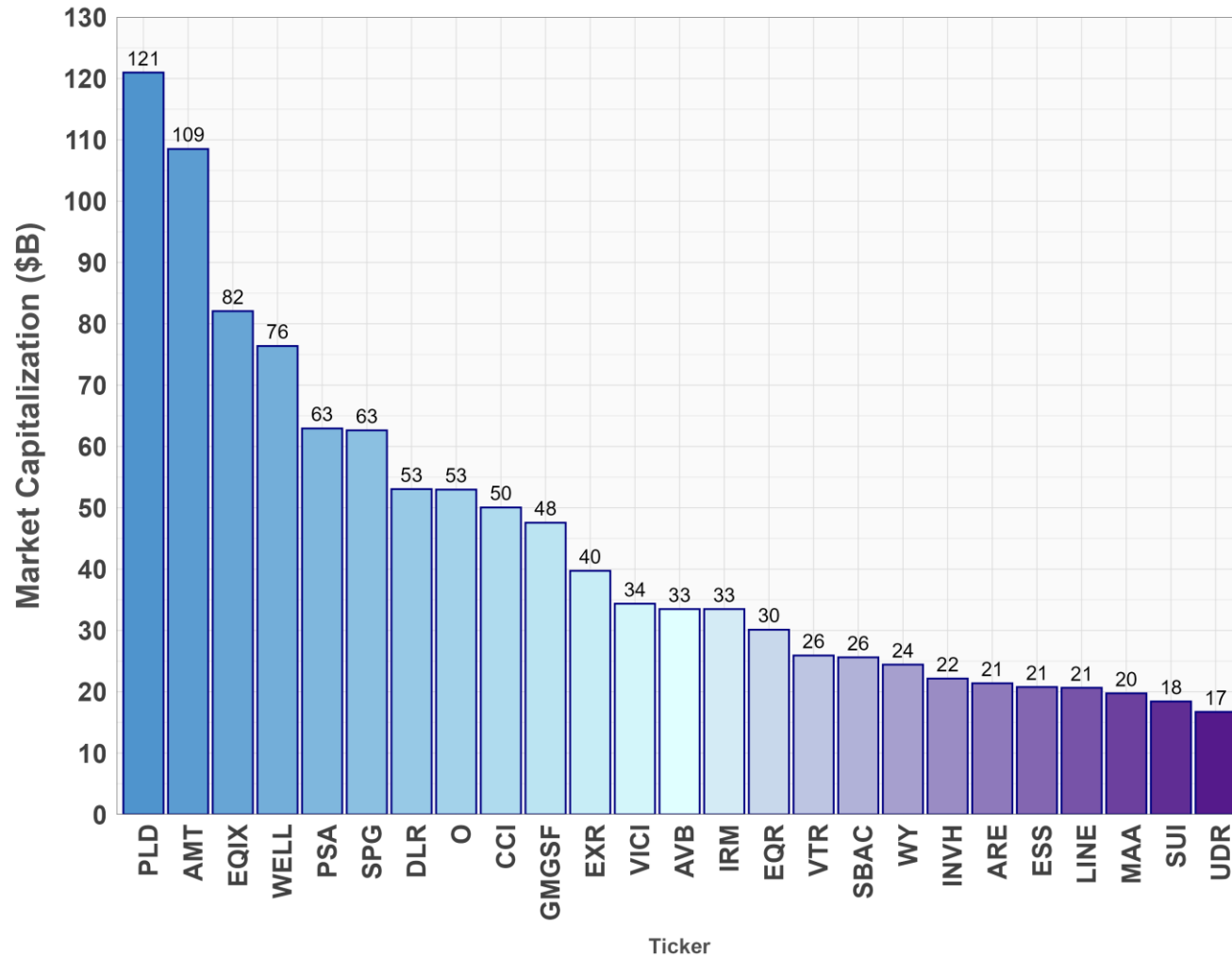
mREITs operates much like a financial institution, but instead of lending money directly, mREITs buy mortgage-backed securities (MBS) and mortgages themselves.

mREITs are unique because of their sensitivity to interest rates. **mREITs are also much more volatile than equity REITs**

# Top 25 REITs

## Top 25 REITs by Market Capitalization

Based on Market Close on 20-Sep-24



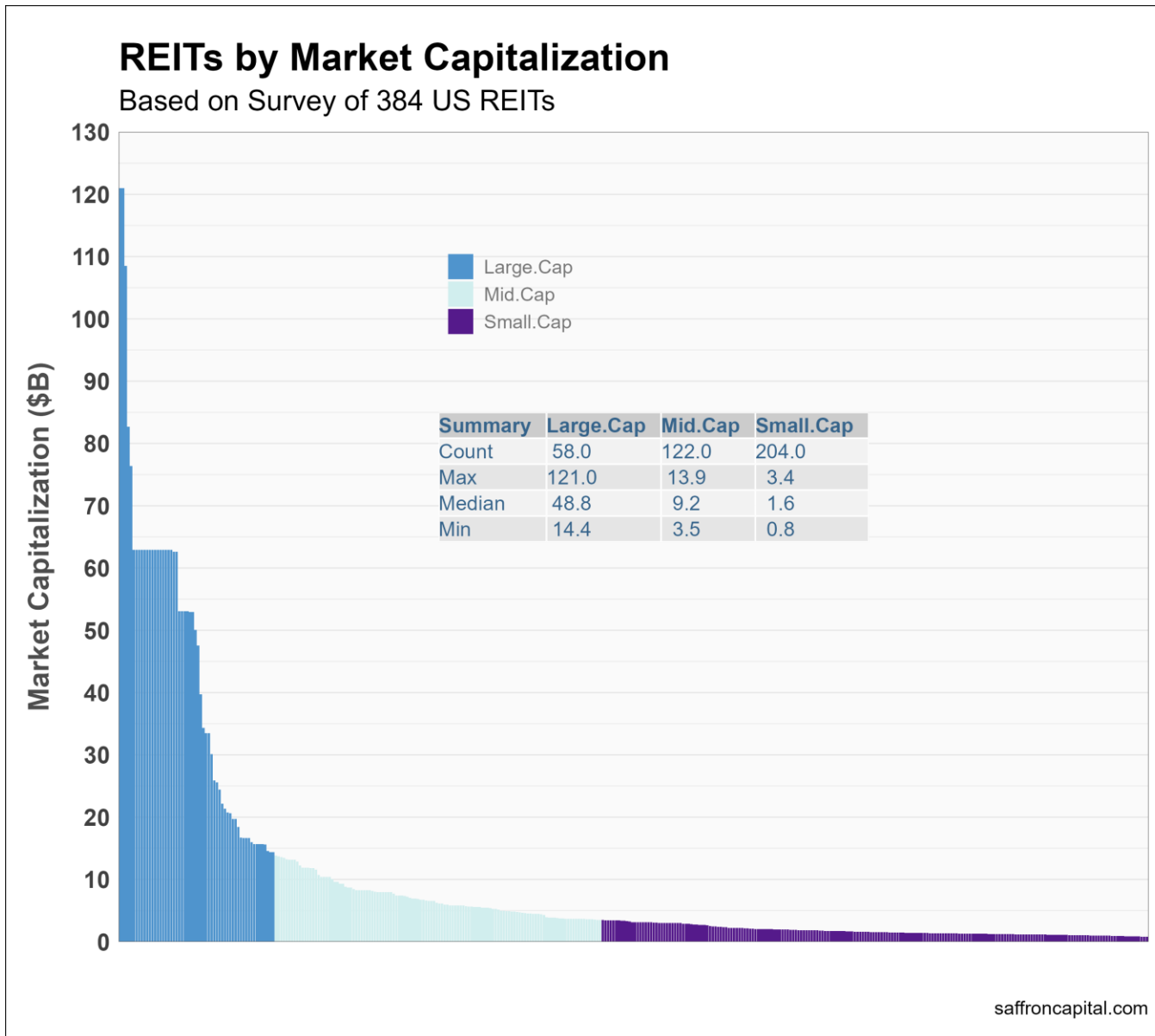
saffroncapital.com

### Why are large-cap REITs strategically appealing?

- Greater financial capacity
- More flexibility to sell non-core assets and to focus on high-performing assets
- Economies of scale for improved expense control
- Economies of scale for in-house development activity and capital gains
- More reliable funds from operations (FFO)



# REIT Market Capitalization



### Large Cap REITs

67% of market cap  
15% of companies

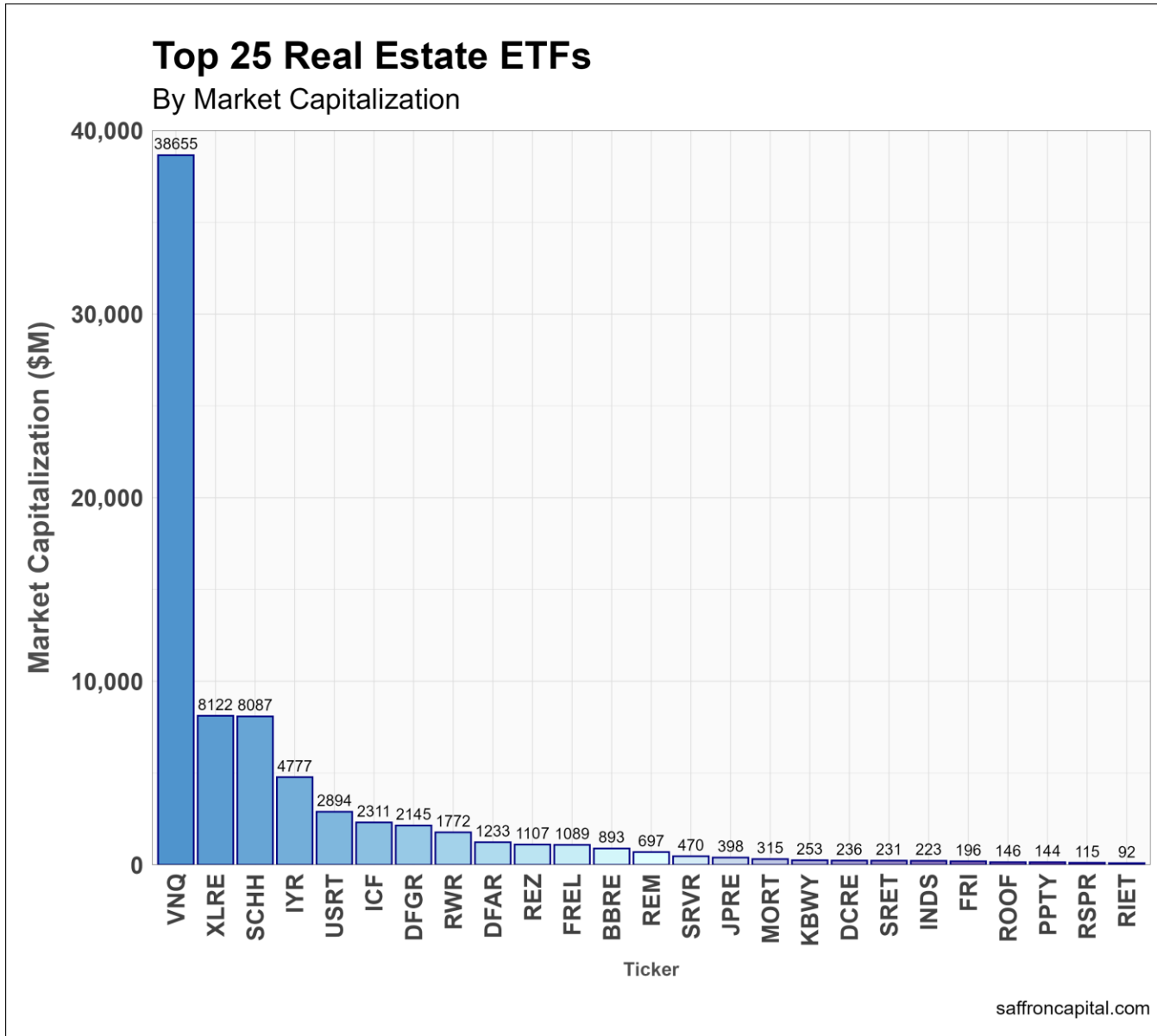
### Mid Cap REITs

23% of market cap  
32% of companies

### Small Cap REITs

10% of market cap  
53% of companies

# REIT ETFs



Many ETFs allocate funds based on REIT market cap. As a result, holdings across ETFs tend to be similar:

- Top 10 holdings are the top 10 REITs
- Percentage allocations per REIT are broadly equivalent

The exceptions are smaller ETFs that focus on specialized REIT portfolios or market niches.

Part 3

# REIT Credit Ratings

# Bond quality

## Agency Credit Ratings

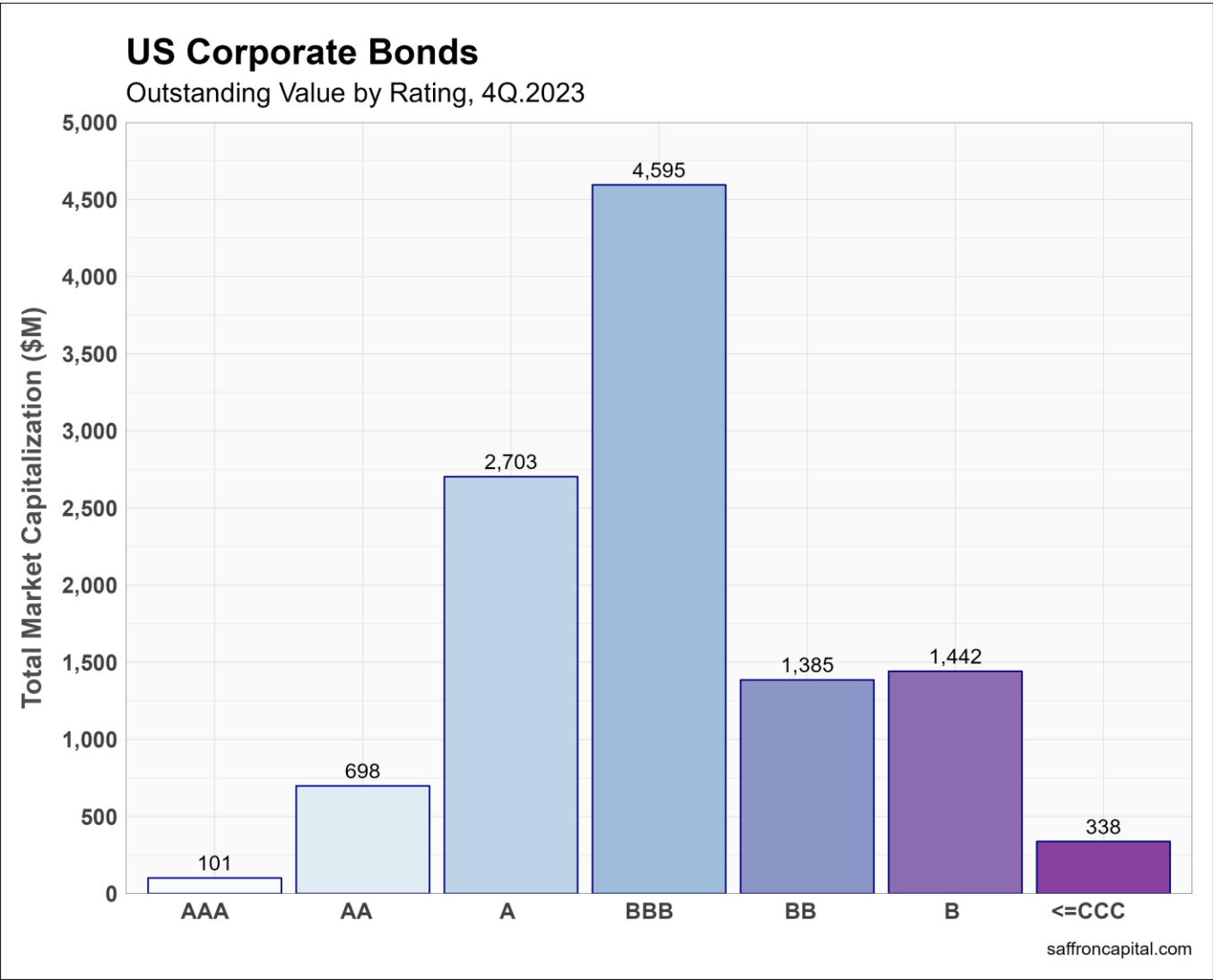
		Credit Rating Scales by Agency		
Class	Quality	Moody's	S&P	Fitch
Investment Grade	Prime	Aaa	AAA	AAA
	High grade	Aa1	AA+	AA+
		Aa2	AA	AA
		Aa3	AA-	AA-
	Upper medium grade	A1	A+	A+
		A2	A	A
		A3	A-	A-
	Lower medium grade	Baa1	BBB+	BBB+
		Baa2	BBB	BBB
		Baa3	BBB-	BBB-
Junk Bonds	Non-investment grade speculative	Ba1	BB+	BB+
		Ba2	BB	BB
		Ba3	BB-	BB-
	Highly speculative	B1	B+	B+
		B2	B	B
		B3	B-	B-
	Substantial risk	Caa1	CCC+	CCC
	Extremely speculative	Caa2	CCC	
		Caa3	CCC-	
	Default imminent with little chance of recovery	Ca	CC	
			C	
	IN DEFAULT	C	D	DDD
				DD
D				

A REIT's credit rating defines the credit worthiness of the trust company.

The ratings are published by rating agencies and used by investment professionals to assess the likelihood the trust will stay in business to pay periodic dividends.

Ratings for REITs cover the full spectrum of investment grade and junk bonds.

# Credit Rating of US Corporate Bonds



The distribution of credit ratings for REITs and US corporate bonds is very similar:

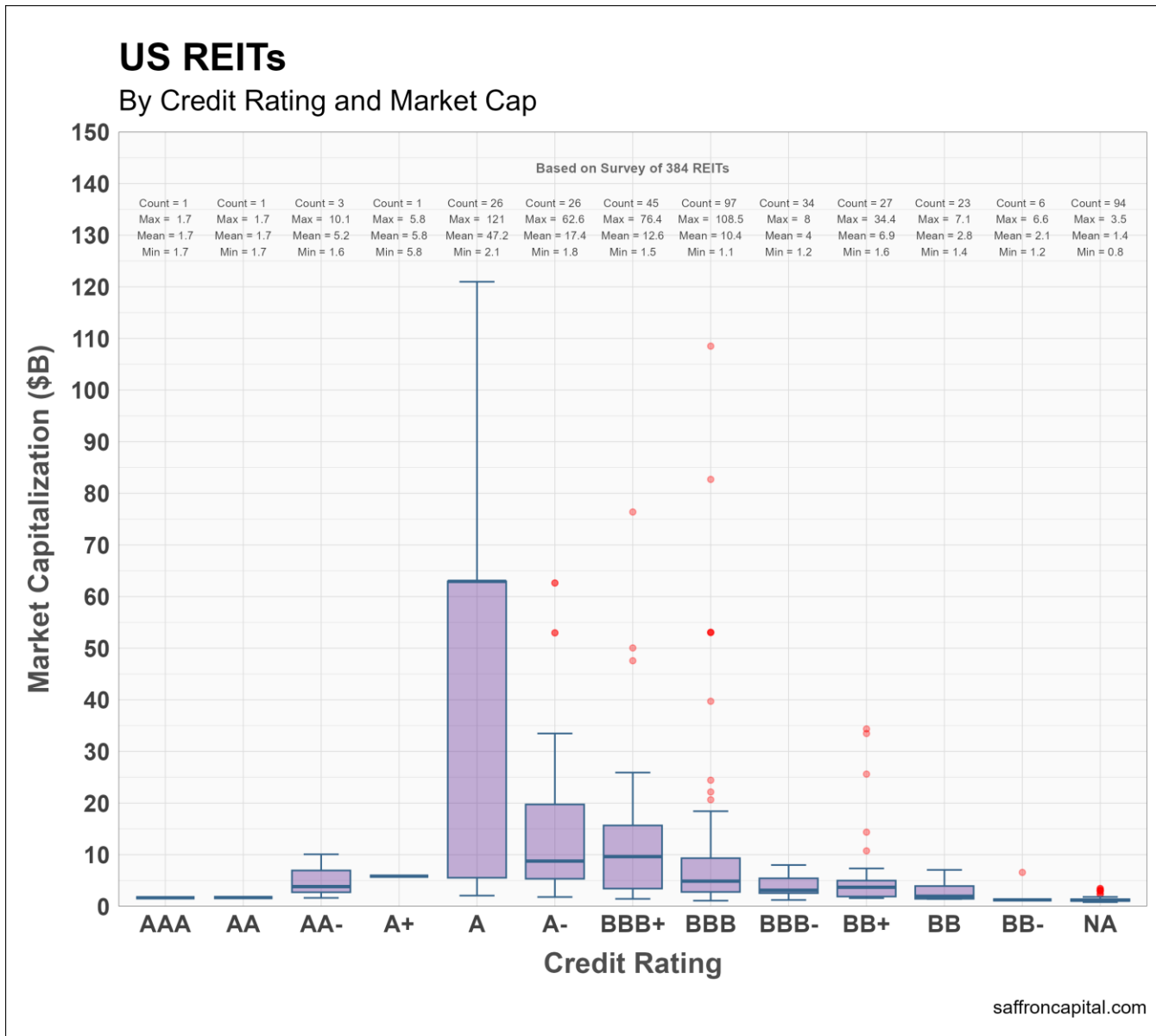
High Grade: 7.2%

Inv. Grade: 73.0%

Junk: 27.0%

Speculative: 3.0%

# REIT Credit Quality



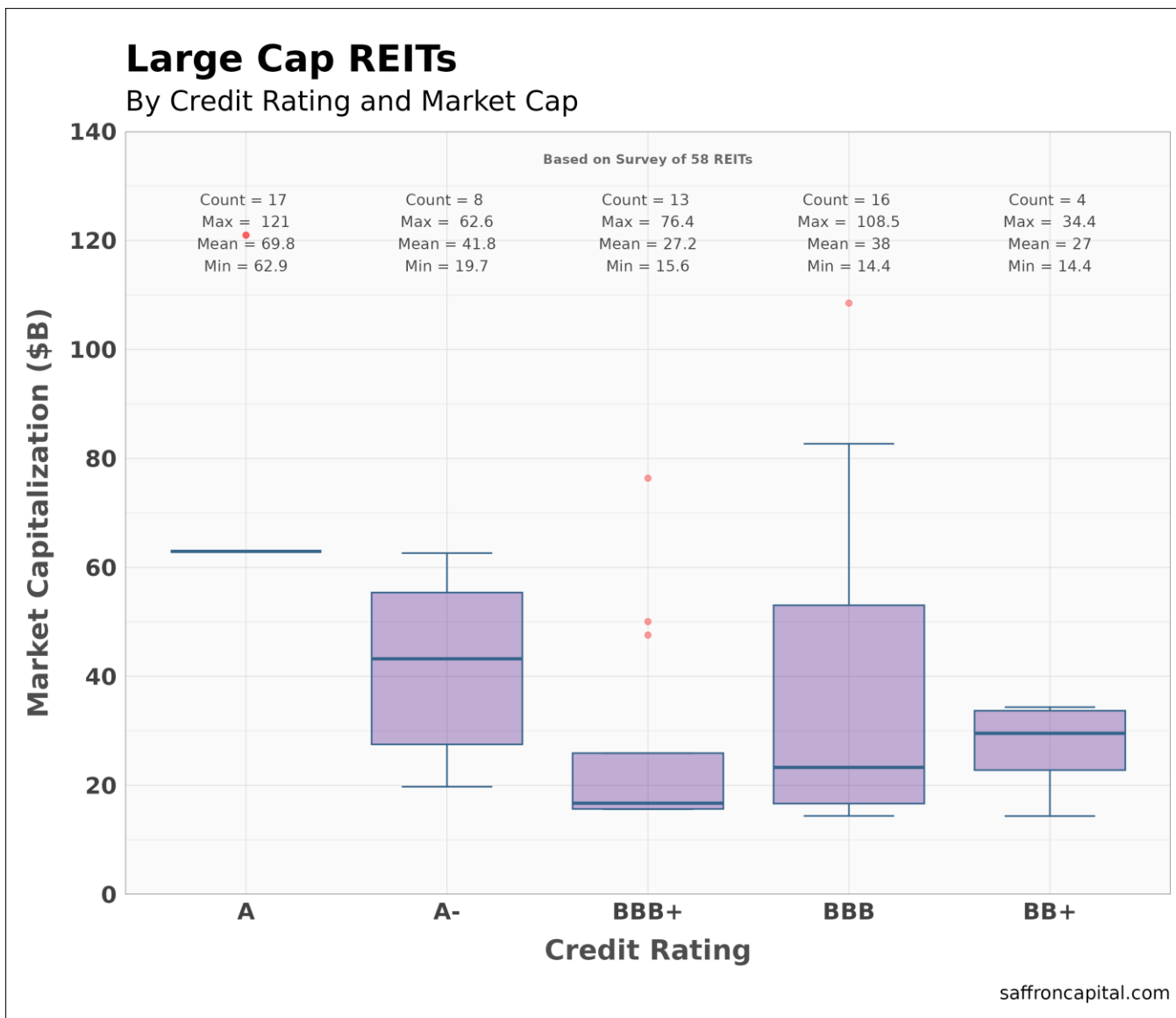
The average credit rating across all REITs

**BBB+**

Qualifies as investment grade, but lower quality



# Large Cap Credit Quality



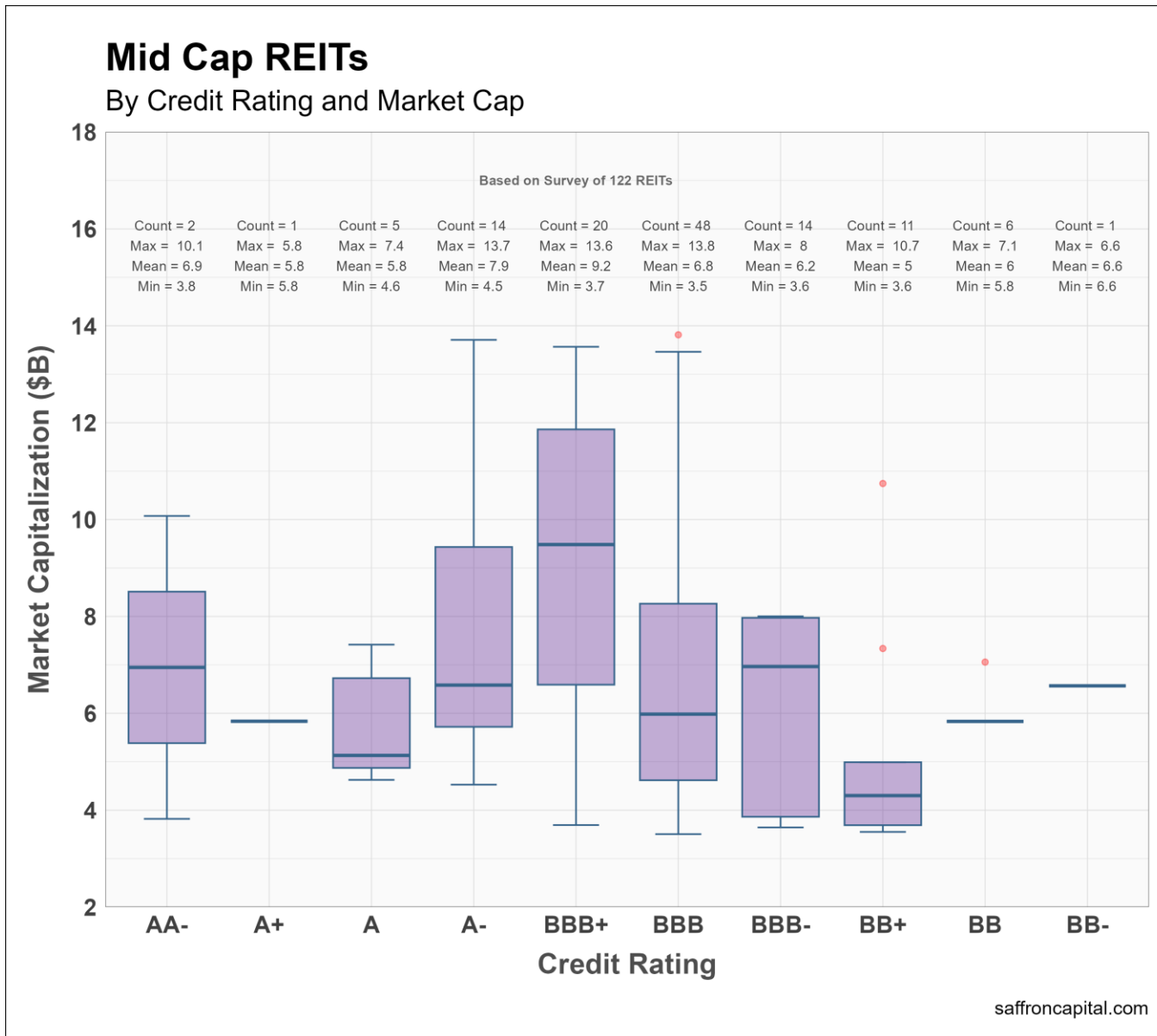
The average credit rating across all large cap REITs

## BBB+

Qualifies as investment grade, but lower quality

Time Horizon Years	Default Probability
1	0.1%
2	0.3%
3	0.5%
4	0.8%
5	1.0%
6	1.3%
7	1.5%
8	1.8%
9	2.0%
10	2.3%

# Mid Cap Credit Quality



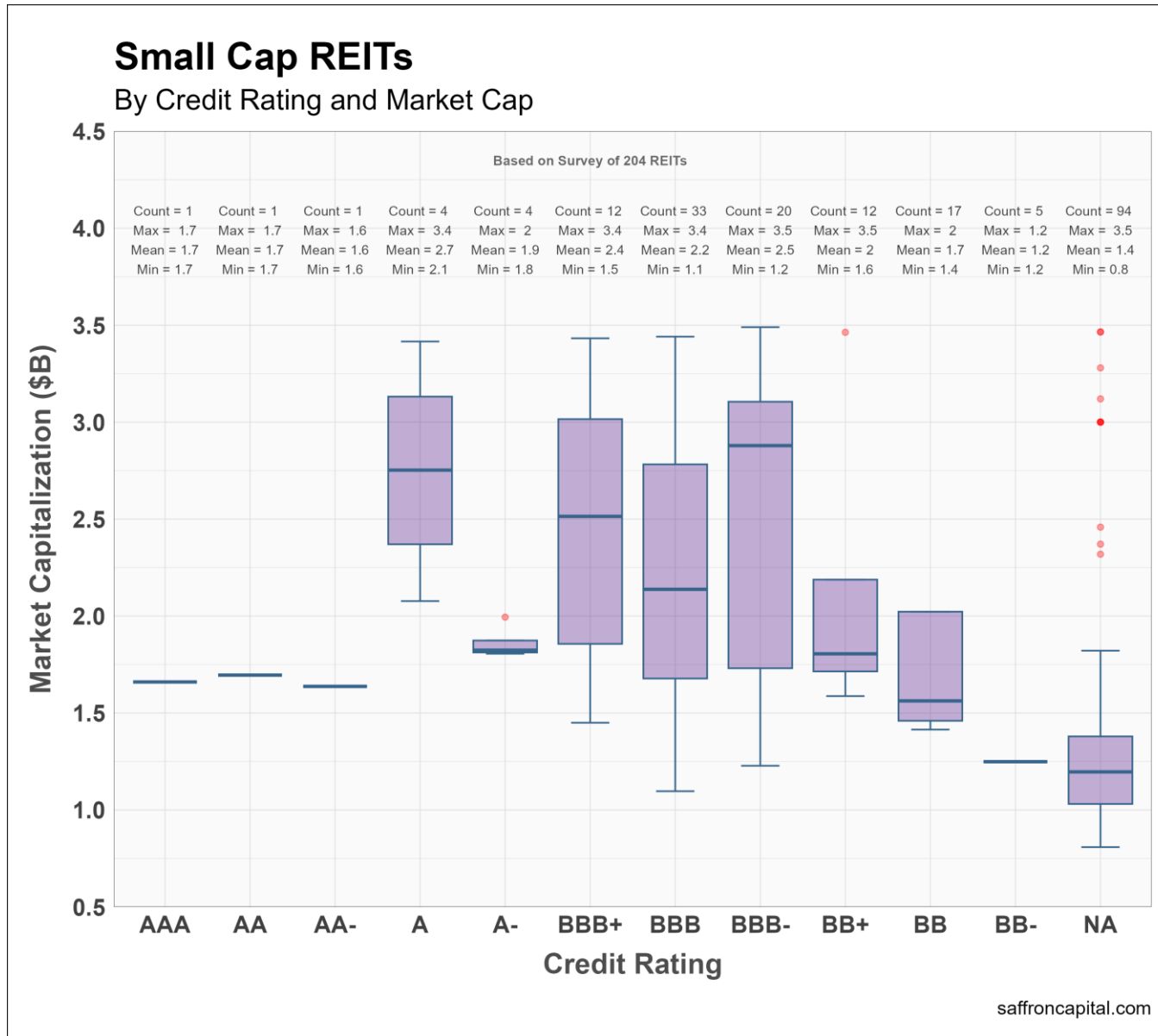
The average credit rating across all mid cap REITs

## BBB

Qualifies as investment grade, but lower quality

Time Horizon Years	Default Probability
1	0.2%
2	0.4%
3	0.7%
4	1.1%
5	1.4%
6	1.8%
7	2.2%
8	2.5%
9	2.9%
10	3.2%

# Small Cap Credit Quality



The average credit rating across all small cap REITs

**BBB-**

Qualifies as investment grade, but lower quality

Time Horizon Years	Default Probability
1	0.3%
2	0.8%
3	1.4%
4	2.1%
5	2.8%
6	3.5%
7	4.1%
8	4.7%
9	5.1%
10	5.5%

Part 4

# REIT Valuation

## Macro Economic Value Drivers & Price Forecasting

# Top 25 REITs

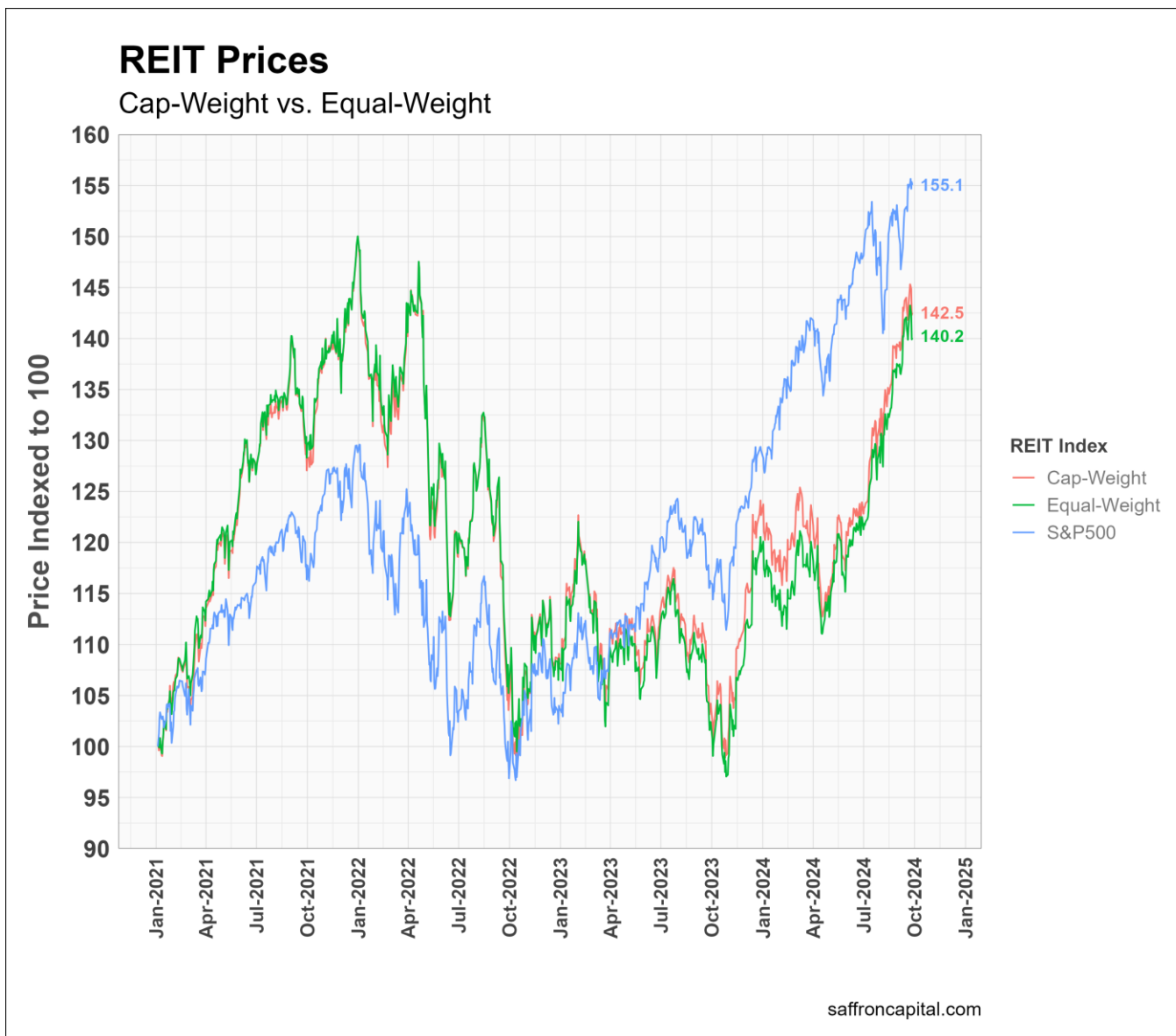


Chart compares prices for the Top 25 REITs versus the S&P 500 Index.

#### Jan.2021 - Mar.2022

- Loose financial conditions
- Historically low rates
- Rising inflation rate
- High earnings growth
- **REITS outperform**

#### Apr.2022 - Jul.2023

- Loose financial conditions
- Rising interest rates
- High inflation
- Declining earnings growth
- **REITS underperform**

#### Aug.2023 - May.2024

- Normalizing financial conditions
- High interest rates
- Falling inflation
- Improving earnings growth
- **REITS Underperform**

#### June 2024 – present

- Normalizing financial conditions
- Falling interest rates
- Falling inflation
- High earnings growth
- **REITS Outperform**

# Top 25 REITs

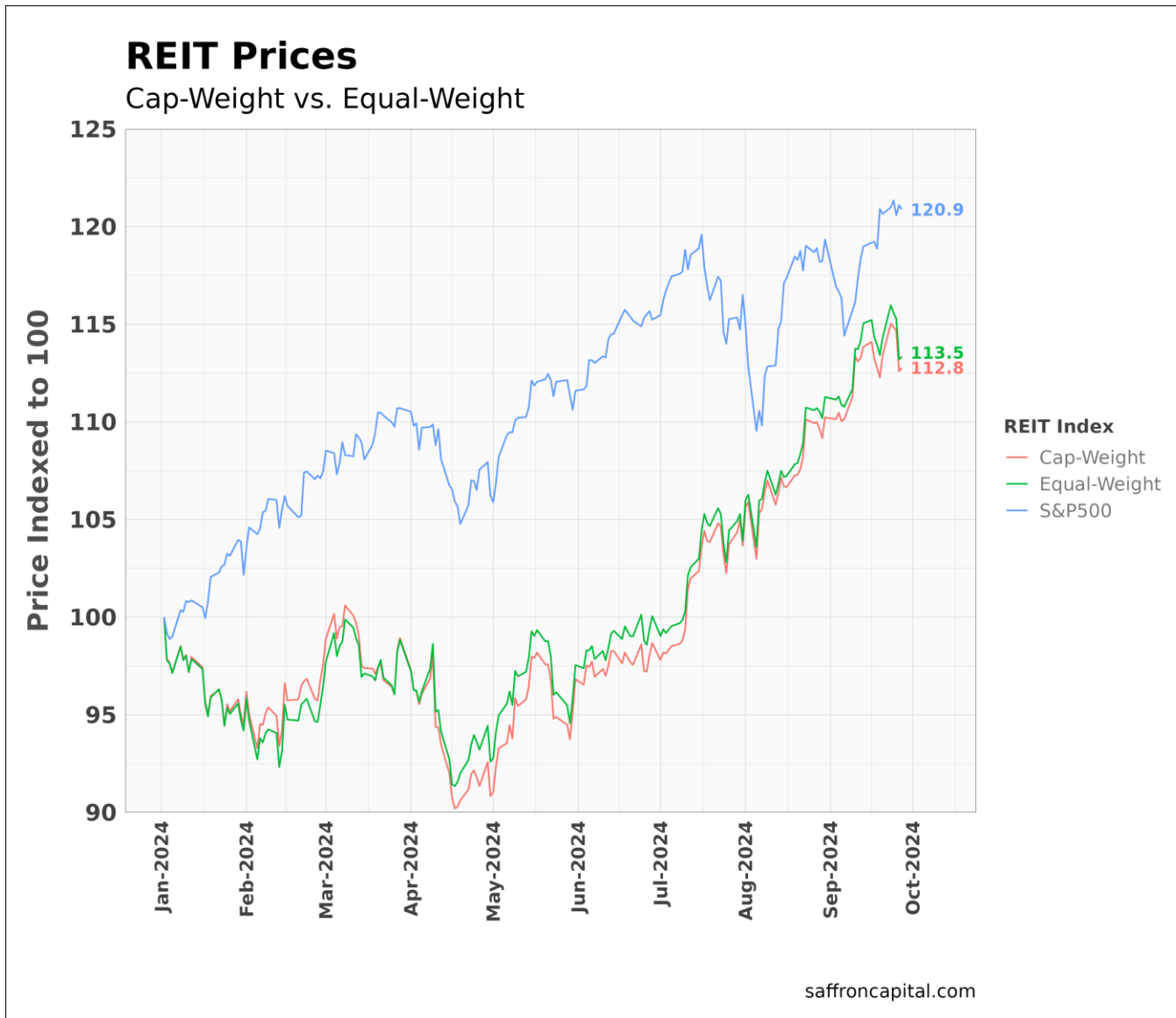
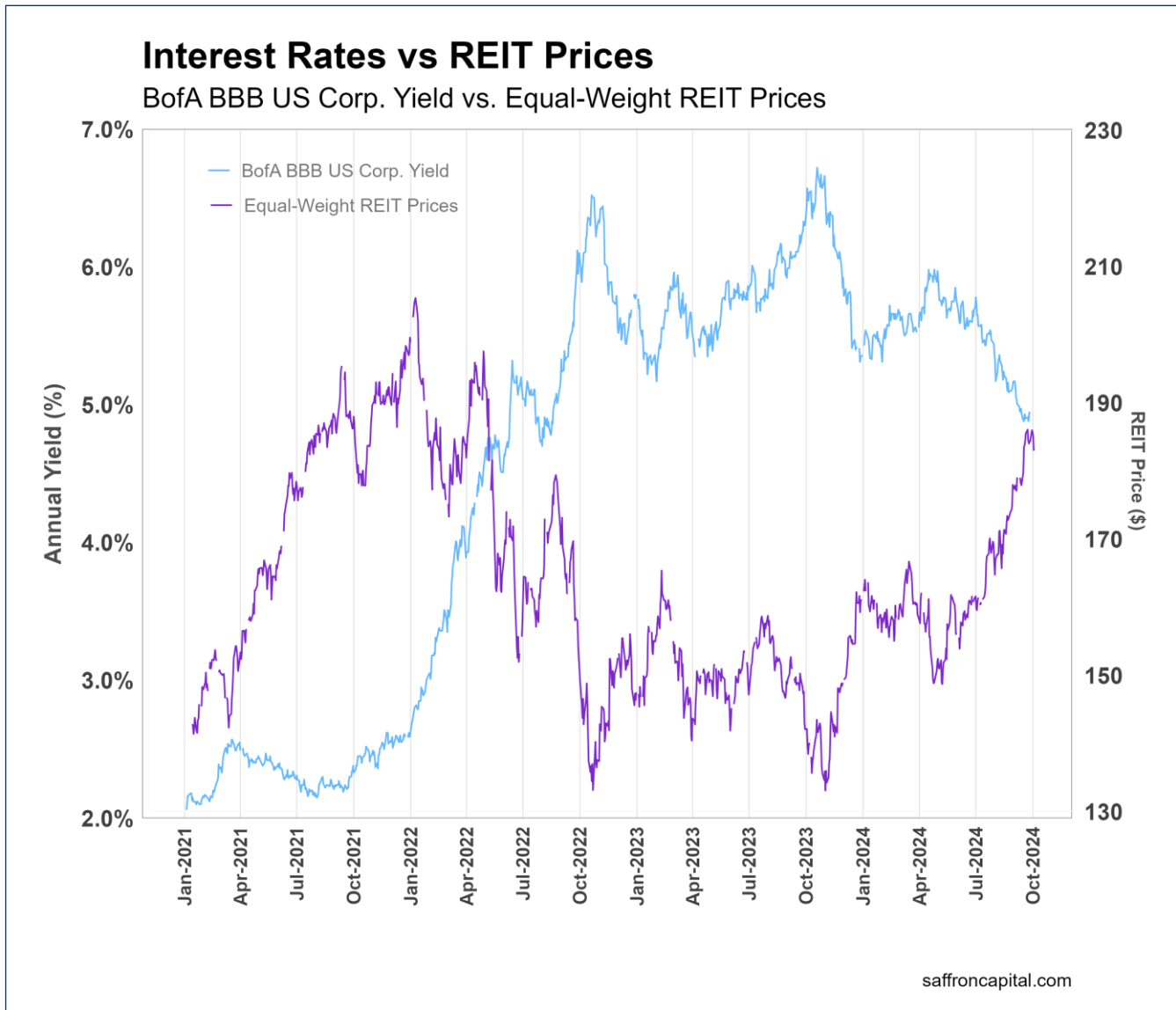


Chart compares prices for the Top 25 REITs versus the S&P 500 Index.

#### June 2024 – present

- Normalizing financial conditions
- Falling interest rates
- Falling inflation
- High earnings growth
- **REITS Outperform**

# Value Driver – Cost of Money

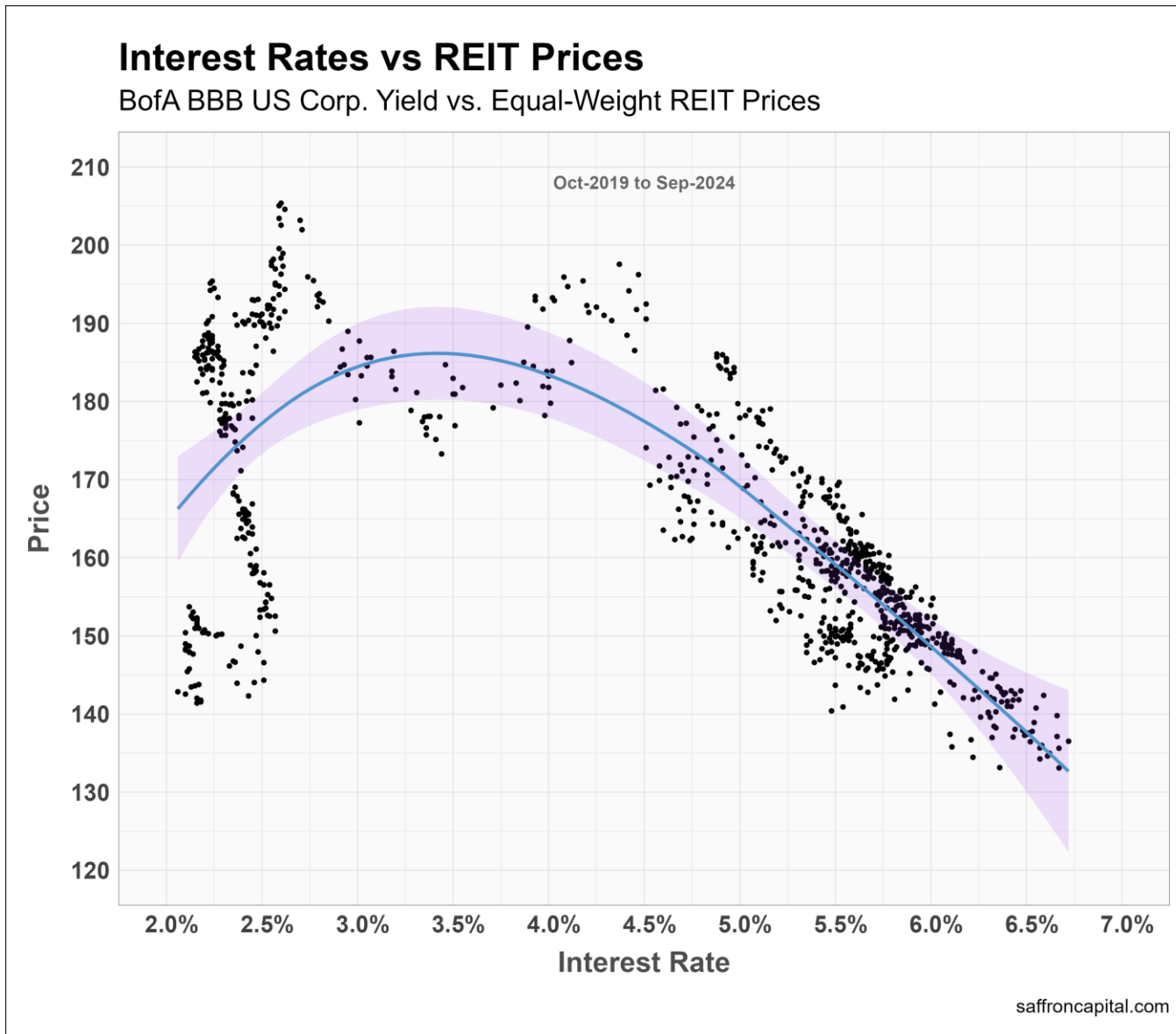


Interest rates UP,  
REIT prices DOWN

Interest Rates DOWN,  
REIT Prices UP

The inverse relationship  
is clear, but is it really  
that simple?

# Value Driver – Cost of Money



The relationship between price is and interest rates is non-linear.

The impact of BBB yields depends on the interest rate level

Between May and October of this year, the yield on BBB bonds dropped from 5.98% to 4.50%

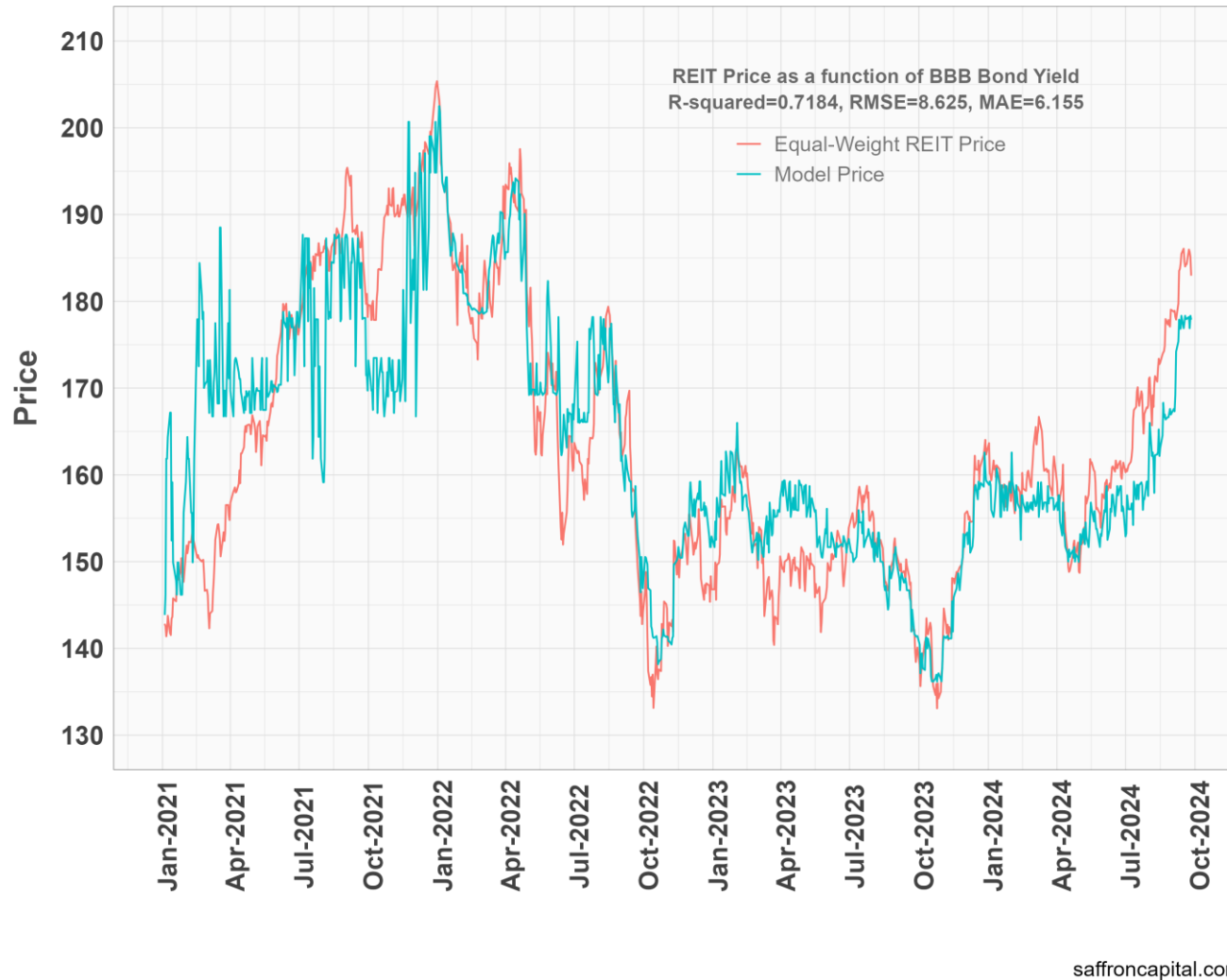
What will happen to prices if yields continue to fall? What if yields rise from 4.5%



# Value Driver – Cost of Money

## Market REIT Prices vs Model Predicted Prices

LOESS Model - Locally Estimated Scatterplot Smoothing

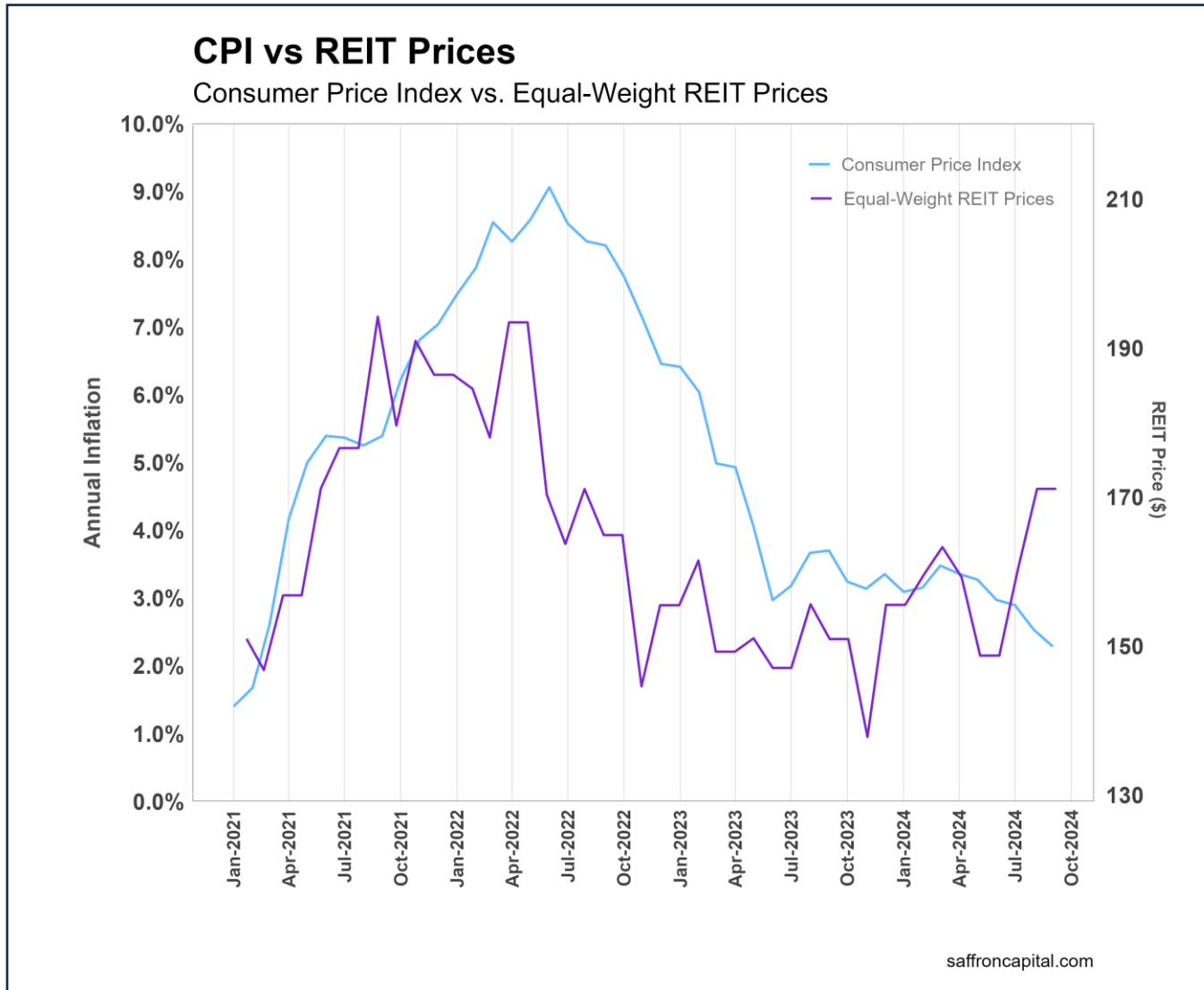


The ability to predict REIT prices based on the BBB corporate bond yield only is reasonable.

**72% of the variation in REIT prices can be explained by interest rates alone.**

The simple macro model generates solid price forecasts. The average error rate varies between 3% and 5% of REIT prices depending on error metric.

# Value Driver – Cost of Money



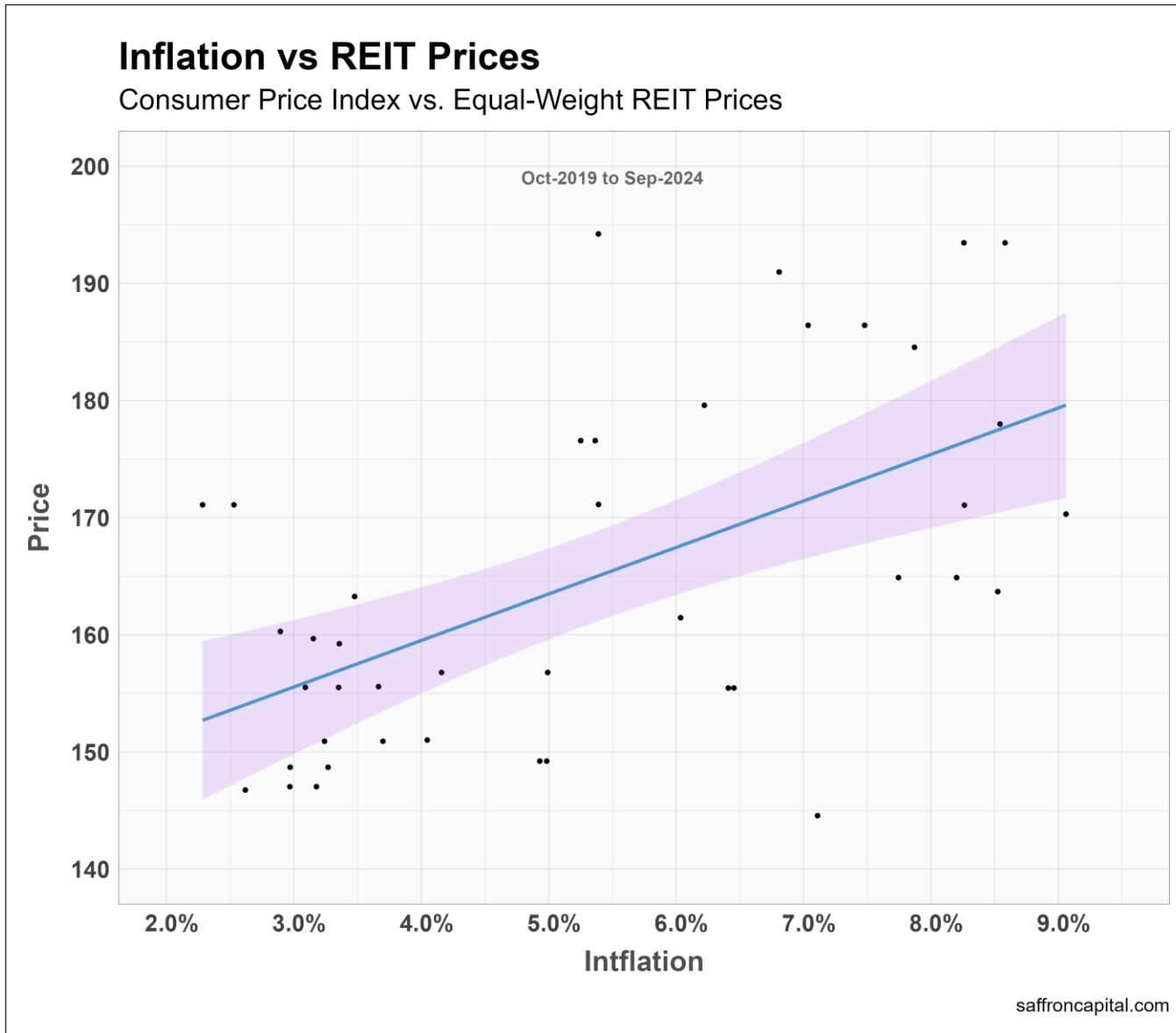
REITS serve as a hedge against inflation.

REIT prices are positively correlated with the Consumer Price Index

Inflation UP,  
REIT prices UP

Inflation DOWN,  
REIT Prices DOWN

# Value Driver – Cost of Money



The relationship between Inflation and REIT prices is linear.

Part 5

# REIT Valuations

## Company Perspective & Target Price Projections

# Key Value Factors

## Market Outlook

- Interest rates
- GDP Growth
- Inflation
- Regulatory change

## Company financial performance

- Net operating income (NOI)
- Funds from operations (FFO)
- Earnings per share (EPS)
- Dividend yield and growth rate
- Debt

## Company Outlook

- Occupancy rates
- Tenant creditworthiness
- Lease expirations
- Revenue outlook
- Cost and operational efficiencies
- Profitability

## Asset Portfolio

- Type(s)
- Location(s)
- Quality
- Diversification



# Valuation Methods

One of the best ways to make great long-term investments is to properly value assets

## Price / AFFO Ratio – Peer Comparison

- Key measure of a REIT's cash generating ability
- Start with income statement
- $P/AFFO = \text{Price} / \text{Adjusted funds from operations per share}$
- Peer metrics define company value

## Price / AFFO Ratio – Historical Comparison

- Same as above
- Company's historical metrics define company value

## Dividend Discount Model

- Key measure of a REIT's intrinsic value
- Start with management guidance/outlook
- Discounting = time value of money + risk
- Accuracy depends on quality of future projections

## Net Asset Valuation

- Key measure of a REIT's intrinsic value
- Start with balance sheet
- $NAV = \text{estimated value of assets} - \text{liabilities}$
- Accuracy depends on quality of future projections



# REIT Case Study

## 123 REIT Inc.

- A fictional large cap REIT with > \$50B in assets
- Case study goal: define company fair value

## Business Description

- The world's digital infrastructure company
- Footprint in 71 markets across 33 countries in the America, Asia, Europe, and Middle East.
- 260 data center locations. Growing by 9 data centers per year
  - Growth tied to growth of bandwidth capacity and digital services
- Data center profile
  - **Properties:** Multi-story, multi-tenant secure facilities; network and technology neutral; internet exchanges for shared traffic
  - **Income:** impacted by ability to obtain favorable lease terms, retain customers and talent, competition and long sales cycles
  - **Expenses:** impacted by debt load, price of power, internet access, inflation, cyber risks, human error, natural disasters, insurance coverage, government audits, sanctions, and penalties
- 10,000+ customers
  - Telecom carriers, mobile and other network providers, cloud and IT service providers, digital media and content providers, financial services, SAS companies, and digital sales for multiple industries.
- 13,151 employees





# REIT Case Study

## 123 REIT Inc.

### Drivers of Financial Results

- Demand for space, power, bandwidth, digital and telecom services
  - Business forecast risks
- Ability to ramp up data center capacity and services
  - Project management complications tied to managing multiple properties, acquisitions, and construction in multiple countries.
  - Delays in construction, power interconnects, equipment supply, budget changes, and labor constraints.
  - Timing of data center upgrades
  - Ability to access capital and credit
- Timing, scope and price of lease renewals
  - Customer discounts and credits
  - Creditworthiness of clients
- Operations and maintenance expenses
  - The availability and price of power
  - Unplanned capital projects
- Timing and magnitude of depreciation, interest expenses, and transaction costs for the purchase or construction of data centers
- Changes in employee stock-based compensation
- Changes in GAAP as released by FASB
- Climate and catastrophe risks





# REIT Net Income



<b>123 REIT Inc.</b>	<b>2023</b>	<b>Annual Growth</b>	<b>2022</b>
<b>Revenue</b>			
Recurring revenue	7,511,300		6,536,900
Non-recurring revenue	243,200		186,300
	<b>7,754,500</b>	15.3%	<b>6,723,200</b>
<b>Expenses</b>			
Property expenses	4,227,700		3,751,500
Selling and marketing expenses	857,700		786,500
General and admin expenses	1,654,600		1,547,800
	<b>6,740,000</b>	10.7%	<b>6,085,800</b>
<b>Operating Income</b>	<b>1,014,500</b>	59.2%	<b>637,400</b>
<b>Non-Operating Income</b>			
Interest Expense	(395,500)		(356,400)
Interest and investment income	94,200		36,300
Other income or expenses	(25,000)		145,700
Gain or loss on property sales	5,100		(4,000)
Asset writedowns	-		-
Other unusual items	431,100		370,600
Income Taxes	(155,600)		(124,800)
	<b>968,800</b>	37.5%	<b>704,800</b>
<b>Net Income</b>			
Earnings from discontinued operations	-		-
Minority interests	200		(200)
	<b>969,000</b>	37.5%	<b>704,600</b>

## Income Statement

A standardized income statement shows net income of \$964M and annual growth of 37.5%.

**Does the net income table accurately reflect trust company performance?**

No! GAAP accounting is suitable for a standard company, but not a REIT.

**REITs are not standard companies with fixed-plant or equipment that depreciate. Property often appreciates with time.**

Hence, GAAP net income is prone to understate a REIT's performance and ability to pay dividends.

Data Source: SEC Edgar System. All values in thousands. Depreciation is a noncash expense (under G&A) that recognizes past capital investments ratably over time. Copyright Saffron Capital. All rights reserved.

# REIT Funds From Operations

<b>123 REIT Inc.</b>	<b>2023</b>	Annual Growth	<b>2022</b>
<b>Funds from Operations</b>			
Net income	969,000		704,600
Real estate depreciation	1,141,900		1,104,700
(Gain) loss of property sales	1,900		7,100
Adjustments from unconsolidated JVs	17,000		10,000
	<b>2,129,800</b>	16.6%	<b>1,826,400</b>
<b>Adjusted Funds from Operations</b>			
FFO	2,129,800		1,826,400
Income tax expense	155,600		124,800
Interest and investment income	(94,200)		(36,300)
Interest expense	395,500		356,400
Amortization and accretion expenses	696,300		643,300
Other income or expenses	11,200		51,400
(Gain) loss on debt retirement	100		(300)
Plus stock-based compensation expense	407,500		404,000
	<b>3,701,800</b>	9.9%	<b>3,369,700</b>

FFO and AFFO present a more accurate picture of the REIT's performance, annual growth, and ability to fund distributions

## Income Statement

Investors in REITS must extend the standard GAAP accounting framework to focus on funds from operations (FFO) or adjusted funds from operations (AFFO).

FFO adjusts net income with the (gain) or loss from property sales, transaction costs, and depreciation.

AFFO is FFO excluding income taxes, interest and investment income, interest expenses, other income or expenses.

# Supplemental Performance Metrics



<b>123 REIT Inc.</b>	<b>2023</b>	<b>Annual Growth</b>	<b>2022</b>
<b>Supplemental Items</b>			
Shares outstanding	93,600	2.2%	91,600
Diluted shares outstanding	94,000	2.4%	91,800
Price per share:	\$ 805.39	21.0%	\$ 665.37
Dividends paid	\$ 1,356,264	19.4%	\$ 1,135,840
<b>Earnings Metrics</b>			
Revenue per share	\$ 82.85	12.9%	\$ 73.40
Basic EPS	\$ 10.35	34.6%	\$ 7.69
FFO per share	\$ 22.75	14.1%	\$ 19.94
AFFO per share	\$ 39.55	7.5%	\$ 36.79
<b>Value Metrics</b>			
Price / earnings ratio	77.80	-10.1%	86.50
Price / FFO ratio	35.40	6.1%	33.37
Price / AFFO ratio	20.36	12.6%	18.09
<b>Dividend and Tax Metrics</b>			
Dividend Per Share	\$ 14.49	16.9%	\$ 12.40
Dividend Yield	1.8%	-3.5%	1.9%
NI payout ratio	140.0%	-13.2%	161.2%
Taxable income payout ratio	120.6%	-11.9%	136.9%
FFO payout ratio	63.7%	2.4%	62.2%
AFFO payout ratio	36.6%	8.7%	33.7%
Effective tax rate	13.8%	-8.0%	15.0%
<b>Management Earnings Guidance</b>			
Period FFO estimate	\$ 22.66		\$ 19.90
Period FFO actual vs estimate	\$ 0.09		\$ 0.04
Number of up revisions	72.7%		70.4%
Number of down revisions	27.3%		29.6%

## Income Statement

Supplemental items define income statement metrics to screen REITs.

Earnings per share (EPS) is not appropriate for REITS as earnings (net income) are deflated relative to FFO and AFFO. FFO/share and AFFO/share are better indicators of the REIT's ability to pay dividends.

The payout ratios exceeds the tax code requirement to pay 90% of taxable income. Trust beneficiaries have solid dividend performance, which impacts stock price and returns.

# REITs – Price/AFFO Ratio

## Valuation Multiple – Pricing Model – Peer Comparison

Ticker	Company	Stock Price	AFFO/share	Price/AFFO	
PLD ☐	PROLOGIS, INC. (XNYS:PLD)	\$ 122.42	\$ 4.36	28.08	
AMT ☐	AMERICAN TOWER CORPORATION (XNYS:AMT)	\$ 223.66	\$ 10.45	21.40	
EQIX ☐	EQUINIX, INC. (XNAS:EQIX)	\$ 876.88	\$ 33.57	26.12	
WELL ☐	WELLTOWER INC. (XNYS:WELL)	\$ 125.56	\$ 3.62	34.70	
PSA ☐	PUBLIC STORAGE. (XNYS:PSA)	\$ 345.40	\$ 14.80	23.34	
DLR ☐	DIGITAL REALTY TRUST, INC. (XNYS:DLR)	\$ 157.00	\$ 5.94	26.43	
O ☐	REALTY INCOME CORPORATION (XNYS:O)	\$ 62.01	\$ 4.12	15.05	
CCI ☐	CROWN CASTLE INC. (XNYS:CCI)	\$ 111.48	\$ 6.93	16.09	
EXR ☐	EXTRA SPACE STORAGE INC. (XNYS:EXR)	\$ 169.48	\$ 7.49	22.62	
VICI ☐	VICI PROPERTIES INC. (XNYS:VICI)	\$ 32.42	\$ 2.22	14.6	
AVB ☐	AVALONBAY COMMUNITIES, INC. (XNYS:AVB)	\$ 221.02	\$ 10.40	21.26	
IRM ☐	IRON MOUNTAIN INCORPORATED (XNYS:IRM)	\$ 118.28	\$ 4.24	27.9	
EQR ☐	EQUITY RESIDENTIAL (XNYS:EQR)	\$ 73.53	\$ 3.55	20.69	
VTR ☐	VENTAS, INC. (XNYS:VTR)	\$ 62.53	\$ 2.42	25.81	
SBAC ☐	SBA Communications Corporation (XNAS:SBAC)	\$ 235.37	\$ 13.27	17.74	
				Average Multiple	22.79
				Median Multiple	22.62
		123 REIT Inc.	\$ 805.39	20.36	
		Price Factor	0.89		
		Company Intrinsic Value/Target Price	\$ 901.46		
		Potential Return	11.9%		

## Model Description

Compare Price/AFFO multiples across the industry.

- Determine industry average and median multiples
- Determine company value factor by dividing company multiple (20.36) by industry average multiple (22.79)
- Divide company price (\$805.39) by company price factor (0.89) to determine company intrinsic value, target price, and potential return.

Price factor suggests company is undervalued versus peers

# REITs – Price/AFFO Ratio

## Valuation Multiples – Pricing Model – Historical Comparison

Year	Share Price	AFFO	Shares		P/AFFO
			Outstanding	AFFO/share	
2023	\$ 805.39	\$ 3,018.50	94.0	\$ 32.11	25.08
2022	\$ 655.03	\$ 2,713.90	91.8	\$ 29.56	22.16
2021	\$ 845.84	\$ 2,451.20	90.4	\$ 27.12	31.19
2020	\$ 714.18	\$ 2,189.10	88.4	\$ 24.76	28.84
2019	\$ 583.70	\$ 1,931.10	84.7	\$ 22.80	25.60
2018	\$ 352.56	\$ 1,659.10	80.2	\$ 20.69	17.04
2017	\$ 453.22	\$ 1,437.00	77.5	\$ 18.54	24.44
2016	\$ 357.41	\$ 1,078.30	70.8	\$ 15.23	23.47
2015	\$ 302.39	\$ 831.80	58.5	\$ 14.22	21.27
2014	\$ 226.72	\$ 761.70	52.4	\$ 14.54	15.60
Average					23.47
Current					20.36
123 REIT Inc. \$					805.39
Price factor					0.87
Company Intrinsic Value/Target Price \$					928.18
Potential Return					15.2%

Price factor suggests company is undervalued versus history

## Model Description

Compare Price/AFFO multiples across time.

- Determine historical average and median multiples
- Determine company value factor by dividing company multiple (20.36) by historical average multiple (23.47)
- Divide company price (\$805.39) by company price factor (0.87) to determine company intrinsic value, target price, and potential return.

# REITs – Dividend Discount Model

## Historical vs Projected Dividend Growth Rates

Year	Annual Dividend	Dividend Payout	Dividend Growth Rate
2023	\$ 14.49	1.80%	16.9%
2022	\$ 12.40	1.89%	8.0%
2021	\$ 11.48	1.36%	7.9%
2020	\$ 10.64	1.49%	8.1%
2019	\$ 9.84	1.69%	7.9%
2018	\$ 9.12	2.59%	14.0%
2017	\$ 8.00	1.77%	14.3%
2016	\$ 7.00	2.43%	(60.5%)
2015	\$ 17.71	5.86%	133.8%
2014	\$ 7.57	3.34%	12.8%
		Average	11.2%
		Median	10.5%
	Projected Dividend Next Year	\$	15.75
	Long-term Dividend Growth Rate		5.8%
	WACC/Discount Rate		7.5%
	123 REIT Inc.	\$	805.39
	Company Intrinsic Value/Target Price	\$	926.47
	Potential Return		15.0%

## Model Description

Review dividend history and payouts over time.

- Determine historical average and median multiples
- Obtain management guidance on next years projected dividend
- Estimate company's long-term dividend growth rate (5.8%)
- Divide projected dividend (\$15.75) by the difference of company WACC (7.5%) and dividend growth (5.8%) to determine company intrinsic value, target price, and potential return.

Long-term dividend growth rate suggests company is undervalued

# REIT Balance Sheet



123 REIT Inc.	2023		2023
<b>Assets</b>		<b>Liabilities</b>	
Gross property and equipment	30,651	Current debt	1,006
Accumulated depreciation	(10,601)	Long-term debt	12,726
Total Real Asset	<b>20,050</b>	Accounts payable	162
<b>Other Assets</b>		Accrued expenses	943
Cash and equivalents	2,096	Current income tax payables	81
Accounts receivables	1,056	Unearned revenue	125
Other receivables	248	Other current liabilities	575
Investments in debt and securities	62	Unearned revenue non-current	154
Goodwill	5,737	Deferred tax liability	394
Other intangibles	1,705	Other non-current liabilities	247
Deferred tax assets	-		<b>16,414</b>
Restricted cash	1	Finance lease liabilities	<b>3,723.20</b>
Other current assets	168		
Deferred long-term charges	533		
Other long-term assets	996		
	<b>12,601</b>		
<b>Total Assets</b>	<b>32,650</b>	<b>Total Liabilities</b>	<b>20,137</b>
<b>Net Asset Value/Stockholder's Equity</b>	<b>12,513</b>		
<b>Supplemental Metrics</b>			
Cap rate - core assets	5.1%		
Cap rate - all assets	3.1%		
Book value / share	\$ 133.69		

## Balance Sheet

The balance sheet assets, liabilities, and net asset value (NAV), also known as shareholder's equity or book value.

### Supplemental statics:

- Cap rate – core equals operating income divided by Total Real Assets.
  - Cap rate – all assets is operating income divided by total assets.
- Cap rate is a profitability metric that is used to value real estate property and portfolios.
- Book value per share is NAV divided by shares outstanding.

# REITs – Net Asset Value Model



NAV Valuation	
Operating Income	1,014,500
Growth rate	10.5%
Next Year Operating Income	1,121,023
Cap rate - all assets	3.1%
Projected asset value	36,162,016
Projected debt value	20,137,200
Net Asset Value	16,024,816
Shares outstanding	93,600
Projected NAV per share	\$ 171.21
Price/Book Value	5.50
Projected Stock Value	\$ 941.63
Potential Return	16.9%

## Model Description

The cap rate for all assets links net operating income to Projected asset value.

Projected debt value can then be combined with projected assets to yield projected NAV.

Projected NAV per share can then be extended to derive a REIT's projected target price using a historical price to book value ratio.

## Sensitivity Analysis

Op Income	Cap Rate				
	2.6%	2.9%	3.1%	3.4%	3.6%
<b>1,235,927</b>	\$ 1,609.95	\$ 1,364.93	\$ 1,159.43	\$ 984.60	\$ 834.06
<b>1,177,074</b>	\$ 1,476.94	\$ 1,243.59	\$ 1,047.87	\$ 881.37	\$ 737.99
<b>1,121,023</b>	\$ 1,350.26	\$ 1,128.02	\$ 941.63	\$ 783.05	\$ 646.50
<b>1,064,971</b>	\$ 1,223.59	\$ 1,012.46	\$ 835.38	\$ 684.74	\$ 555.01
<b>1,011,723</b>	\$ 1,103.24	\$ 902.67	\$ 734.45	\$ 591.34	\$ 468.10

Sensitivity analysis shows how the REIT target price can change given different input assumptions.



# REIT Value Consolidation

<b>123 REIT Inc.</b>	\$	805.39	
<b>Valuation Method</b>		<b>Projected Price</b>	<b>Potential Return</b>
AFFO Multiple - Peer Comparison Model	\$	901.46	11.9%
AFFO Multiple - Historical Comparison Model	\$	928.18	15.2%
Dividend Discount Model	\$	926.47	15.0%
Net Asset Value Model	\$	941.63	16.9%
			<b>Analyst Weights</b>
Median	\$	927.33	15.1%
Simple Average	\$	924.44	14.8%
Weighted Average	\$	929.12	15.4%
Margin of safety		0.0%	
<b>Analysts projected price</b>	\$	<b>929.12</b>	<b>15.4%</b>

## Model Results

Projected REIT values by model shows results that are broadly similar.

There are several ways to consolidate results. For example:

- Median
- Simple average
- Weighted average

The weighted average is Poor's subjective based on the analyst confidence in each method.

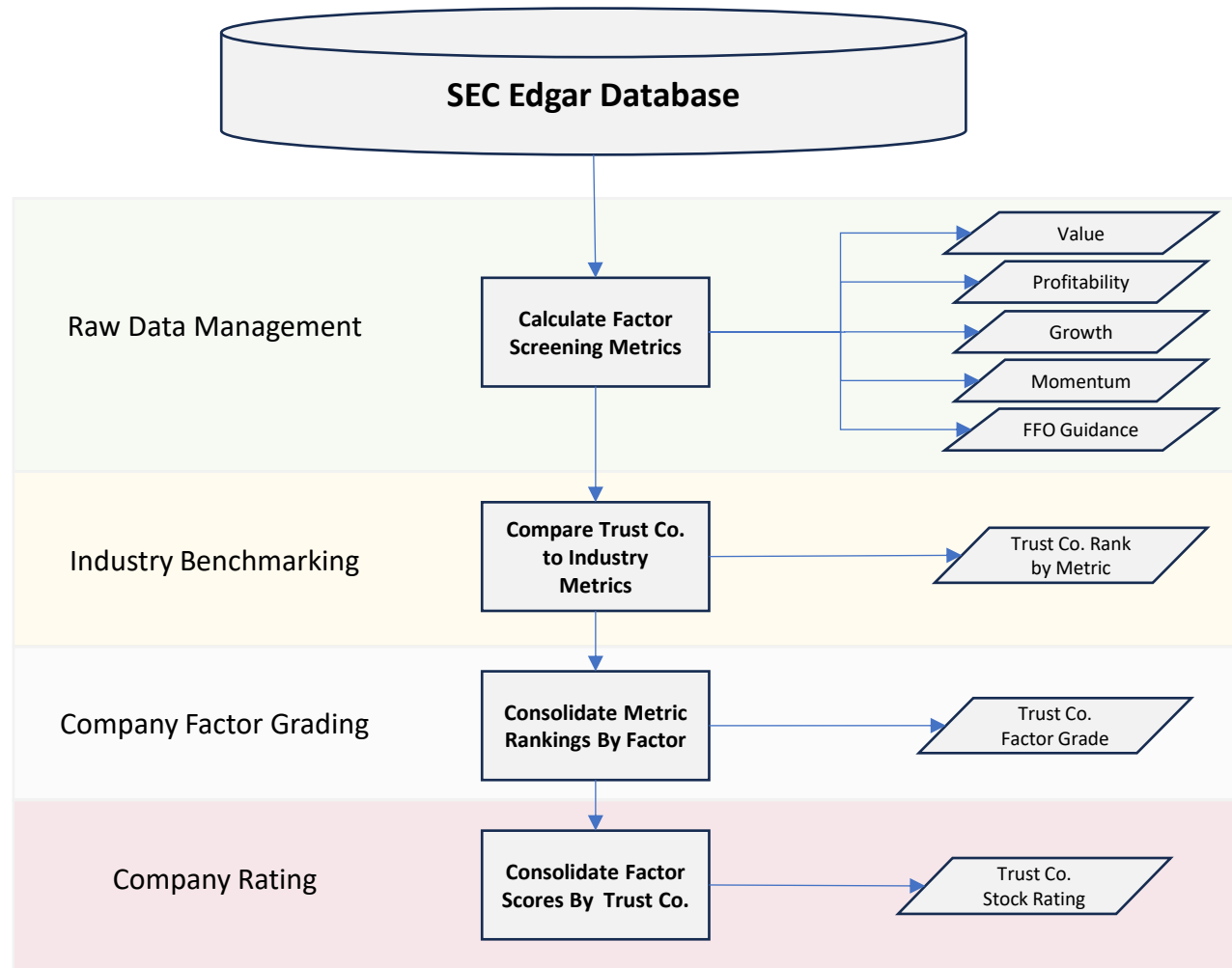
A margin of safety can also be used to define a purchase price below the estimated target price.

Part 6

# REIT Screening Process

# Screening Process

## Flow Diagram – First Pass



The screening process uses 5 factors to assess and rank exchange-listed REITS

- Value
- Profitability
- Growth
- Momentum
- FFO Guidance

Each factor contributes to stock price returns and is defined by income statement and balance sheet metrics.

The number of metrics per factor are listed below along with their rating weights:

Factor	# Metrics	Weight
Value	15	18%
Growth	25	20%
Profitability	29	25%
Momentum	4	25%
FFO Guidance	4	12%

# Factor Metrics

## Financial Statement Performance Indicators

<b>Valuation</b>	<b>Growth</b>	<b>Profitability</b>
P / AFFO (TTM)	AFFO Growth (TTM)	AFFO Payout Ratio (FWD)
P / AFFO (FWD)	AFFO Growth (FWD)	AFFO Payout Ratio (TTM)
P / FFO (TTM)	AFFO Growth (5Y Hist. CAGR)	AFFO / Total Revenue (TTM)
P / FFO (FWD)	FFO Growth (TTM)	AFFO Yield (TTM)
EV / EBITDA TTM	FFO Growth (FWD)	Cash Dividend Payout Ratio (TTM)
EV / EBITDA FWD	FFO Growth (5Y Hist. CAGR)	Cash From Operations (TTM)
Price / Sales TTM	Dividend Growth Rate (TTM)	Cash Per Share (TTM)
Price / Book TTM	Dividend Per Share Growth (FWD)	Dividend Payout Ratio (TTM)
Price / Cash Flow TTM	Dividend Growth Rate 5Y (CAGR)	EBIT Margin (TTM)
Price / Rental Revenue (TTM)	Consecutive Years of Dividend Growth	EBITDA Margin (TTM)
Dividend Yield (TTM)	EBITDA Growth (TTM)	FFO Dividend Coverage Ratio (FWD)
Total Debt/Equity (TTM)	EBITDA Growth (FWD)	FFO Dividend Coverage Ratio (TTM)
5-Year Avg Dividend Yield	EBITDA Growth (5Y Hist. CAGR)	FFO To Gross Margin (TTM)
Dividend Yield (FWD)	Operating Cash Flow Growth (YoY)	FFO Interest Coverage Ratio (TTM)
Net Long Debt / Assets (TTM)	Operating Cash Flow Growth (FWD)	FFO Payout Ratio (FWD)
	Operating Cash Flow Growth (5Y Hist. CAGR)	FFO Payout Ratio (TTM)
	Revenue Growth (YoY)	FFO/Total Revenue (TTM)
<b>Momentum</b>	Revenue Growth (FWD)	FFO Yield (TTM)
3Mo Price Performance	Revenue Growth (5Y Hist. CAGR)	Gross Profit Margin (TTM)
6Mo Price Performance	CAPEX Growth (YoY)	Interest Coverage (TTM)
9Mo Price Performance	ROE Growth (TTM)	Net Income Per Employee (TTM)
12Mo Price Performance	ROE Growth (FWD)	Net Income/Total Debt (TTM)
	Working Capital Growth (YoY)	Net Income Margin (TTM)
<b>Management Earnings Guidance</b>	Free Cash Flow / Share Growth Rate (TTM)	Rents / Average Gross Properties (TTM)
FFO/share - # of Up Revisions	Free Cash Flow/ Share Growth Rate (FWD)	Return on Total Assets (TTM)
FFO/share - # of Down Revisions		Return on Total Capital (TTM)
Revenue - # of Up Revisions		Return on Common Equity (TTM)
Revenue - # of Down Revisions		



# First-Pass Screening Results

## Top REITs Based on Trust Co. Factor Grade (MktCap >=\$3B)

Rank	Symbol	Company Name	Trust Co.							FFO	
			Trust Co. Rating	Factor Grade	Market Cap	Div Yield	Valuation	Growth	Profitability	Momentum	Guidance
1	IIPR	Innovative Industrial Properties, Inc.	STRONG BUY	90.74	3.72B	5.7%	88	98	95	95	65
2	EPRT	Essential Properties Realty Trust, Inc.	STRONG BUY	90.71	5.70B	3.6%	75	98	98	95	78
3	CTRE	CareTrust REIT, Inc.	STRONG BUY	90.64	4.68B	3.8%	81	90	95	95	88
4	ADC	Agree Realty Corporation	BUY	89.15	7.42B	4.0%	75	90	95	90	95
5	VICI	VICI Properties Inc.	BUY	88.89	33.95B	5.2%	88	98	98	75	85
6	NNN	NNN REIT, Inc.	BUY	87.73	8.80B	4.8%	81	88	98	81	90
7	O	Realty Income Corporation	BUY	87.54	54.11B	5.0%	81	98	95	81	78
8	SPG	Simon Property Group, Inc.	BUY	87.12	63.57B	4.7%	85	78	98	88	81
9	GLPI	Gaming and Leisure Properties, Inc.	BUY	86.74	14.41B	5.9%	88	88	95	75	90
10	SKT	Tanger Inc.	BUY	86.44	3.81B	3.2%	81	78	90	88	98
11	NHI	National Health Investors, Inc.	BUY	86.43	3.76B	4.4%	81	71	90	95	95
12	EPR	EPR Properties	BUY	86.41	3.61B	7.1%	90	88	95	78	78
13	RHP	Ryman Hospitality Properties, Inc.	BUY	85.69	6.79B	3.9%	81	98	88	71	98
14	HIW	Highwoods Properties, Inc.	BUY	85.24	3.55B	6.1%	88	68	85	95	90
15	EXR	Extra Space Storage Inc.	BUY	85.2	37.38B	3.8%	75	95	85	85	85
16	KRG	Kite Realty Group Trust	BUY	85.1	5.79B	3.8%	78	90	85	85	88
17	LAMR	Lamar Advertising Company	BUY	85.08	13.57B	4.0%	81	85	90	88	75
18	OUT	OUTFRONT Media Inc.	BUY	84.91	3.00B	6.6%	90	81	68	95	98
19	BRX	Brixmor Property Group Inc.	BUY	84.68	8.22B	4.0%	81	71	90	88	95
20	ESS	Essex Property Trust, Inc.	BUY	83.85	19.27B	3.3%	65	85	90	85	95
21	KRC	Kilroy Realty Corporation	BUY	83.55	4.53B	5.7%	85	81	90	75	90
22	AVB	AvalonBay Communities, Inc.	BUY	83.5	32.10B	3.1%	65	85	95	81	90
23	CDP	COPT Defense Properties	BUY	83.35	3.56B	3.8%	78	75	85	90	88
24	OHI	Omega Healthcare Investors, Inc.	BUY	83.21	10.44B	6.8%	90	71	81	88	88
25	KIM	Kimco Realty Corporation	BUY	83	15.46B	4.2%	75	81	85	85	90

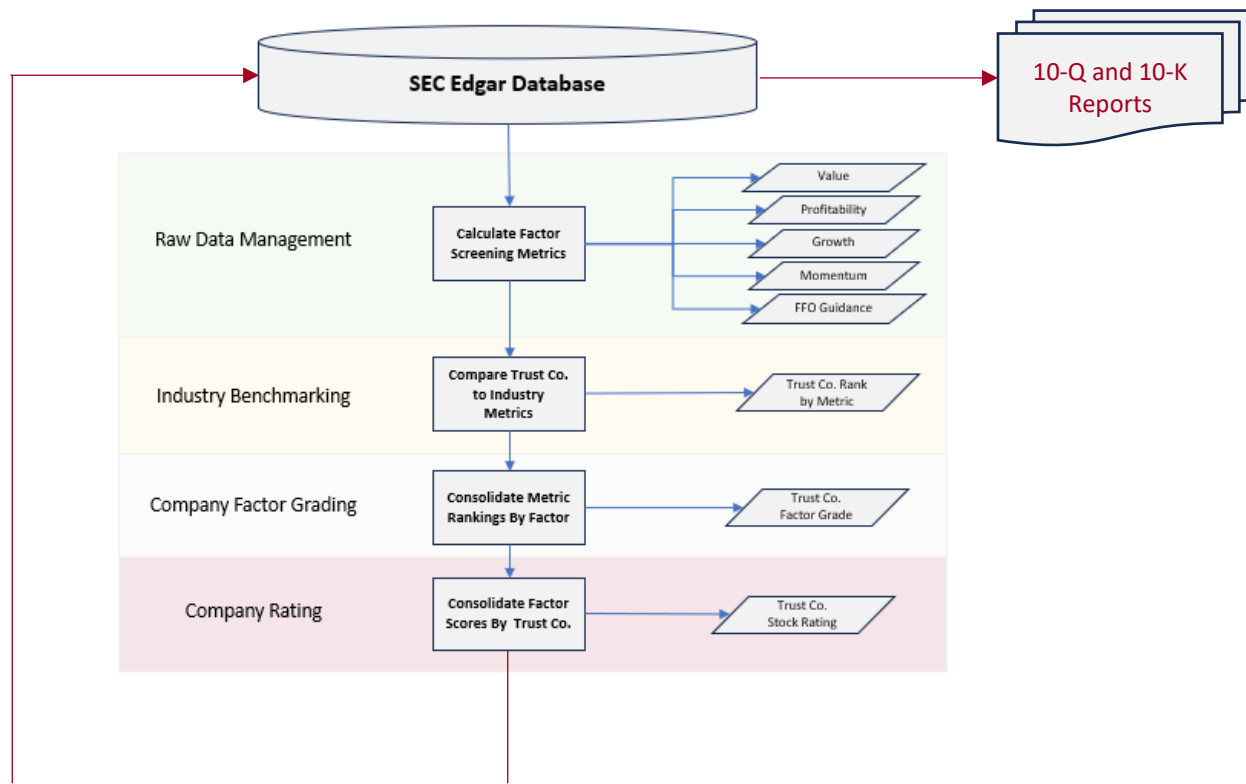
# First-Pass Screening Results

## Top REITs Based on Dividend Yield (MktCap >=\$3B)

Rank	Symbol	Company Name	Trust Co.				FFO				
			Trust Co. Rating	Factor Grade	Market Cap	Div Yield	Valuation	Growth	Profitability	Momentum	Guidance
1	PK	Park Hotels & Resorts Inc.	HOLD	65.72	3.02B	11.6%	98	90	68	55	68
2	HR	Healthcare Realty Trust Incorporated	HOLD	61.97	6.43B	7.1%	88	85	55	78	68
3	EPR	EPR Properties	BUY	73.12	3.61B	7.1%	90	88	95	78	78
4	OHI	Omega Healthcare Investors, Inc.	HOLD	66.57	10.44B	6.8%	90	71	81	88	88
5	SBRA	Sabra Health Care REIT, Inc.	HOLD	62.57	4.21B	6.7%	90	68	68	88	95
6	OUT	OUTFRONT Media Inc.	HOLD	66.66	3.00B	6.6%	90	81	68	95	98
7	BNL	Broadstone Net Lease, Inc.	HOLD	67.48	3.59B	6.3%	85	75	88	81	85
8	APLE	Apple Hospitality REIT, Inc.	HOLD	66.61	3.66B	6.3%	90	90	78	55	55
9	HIW	Highwoods Properties, Inc.	HOLD	67.26	3.55B	6.1%	88	68	85	95	90
10	GLPI	Gaming and Leisure Properties, Inc.	BUY	72.36	14.41B	5.9%	88	88	95	75	90
11	WPC	W. P. Carey Inc.	HOLD	67.78	13.19B	5.8%	85	71	98	71	71
12	IIPR	Innovative Industrial Properties, Inc.	BUY	77.26	3.72B	5.7%	88	98	95	95	65
13	KRC	Kilroy Realty Corporation	HOLD	68.76	4.53B	5.7%	85	81	90	75	90
14	DOC	Healthpeak Properties, Inc.	HOLD	64.33	15.78B	5.4%	78	81	75	81	88
15	VICI	VICI Properties Inc.	BUY	75.61	33.95B	5.2%	88	98	98	75	85
17	O	Realty Income Corporation	BUY	74.18	54.11B	5.0%	81	98	95	81	78
16	NSA	National Storage Affiliates Trust	HOLD	65.77	5.06B	5.0%	81	85	71	88	55
18	BXP	BXP, Inc.	HOLD	65.26	14.30B	4.9%	81	75	78	90	90
19	NNN	NNN REIT, Inc.	BUY	72.43	8.80B	4.8%	81	88	98	81	90
20	SPG	Simon Property Group, Inc.	BUY	71.57	63.57B	4.7%	85	78	98	88	81
21	SLG	SL Green Realty Corp.	HOLD	61.27	4.69B	4.5%	85	55	75	98	90
22	HST	Host Hotels & Resorts, Inc.	HOLD	68.71	12.72B	4.5%	88	88	90	55	55
23	ARE	Alexandria Real Estate Equities, Inc.	HOLD	67.01	20.10B	4.5%	71	95	85	65	65
24	NHI	National Health Investors, Inc.	HOLD	67.86	3.76B	4.4%	81	71	90	95	95
25	CUZ	Cousins Properties Incorporated	HOLD	63.66	4.40B	4.4%	78	68	81	90	95

# Screening Process

## Flow Diagram – Second Pass



The first pass screen is a ‘heuristic’ problem solving process:

- Simplistic method
- Quick and approximate results based on educated guesses
- “Rules of thumb” to cut corners
- Prone to oversight, bias, or error
- Commonly used by AI

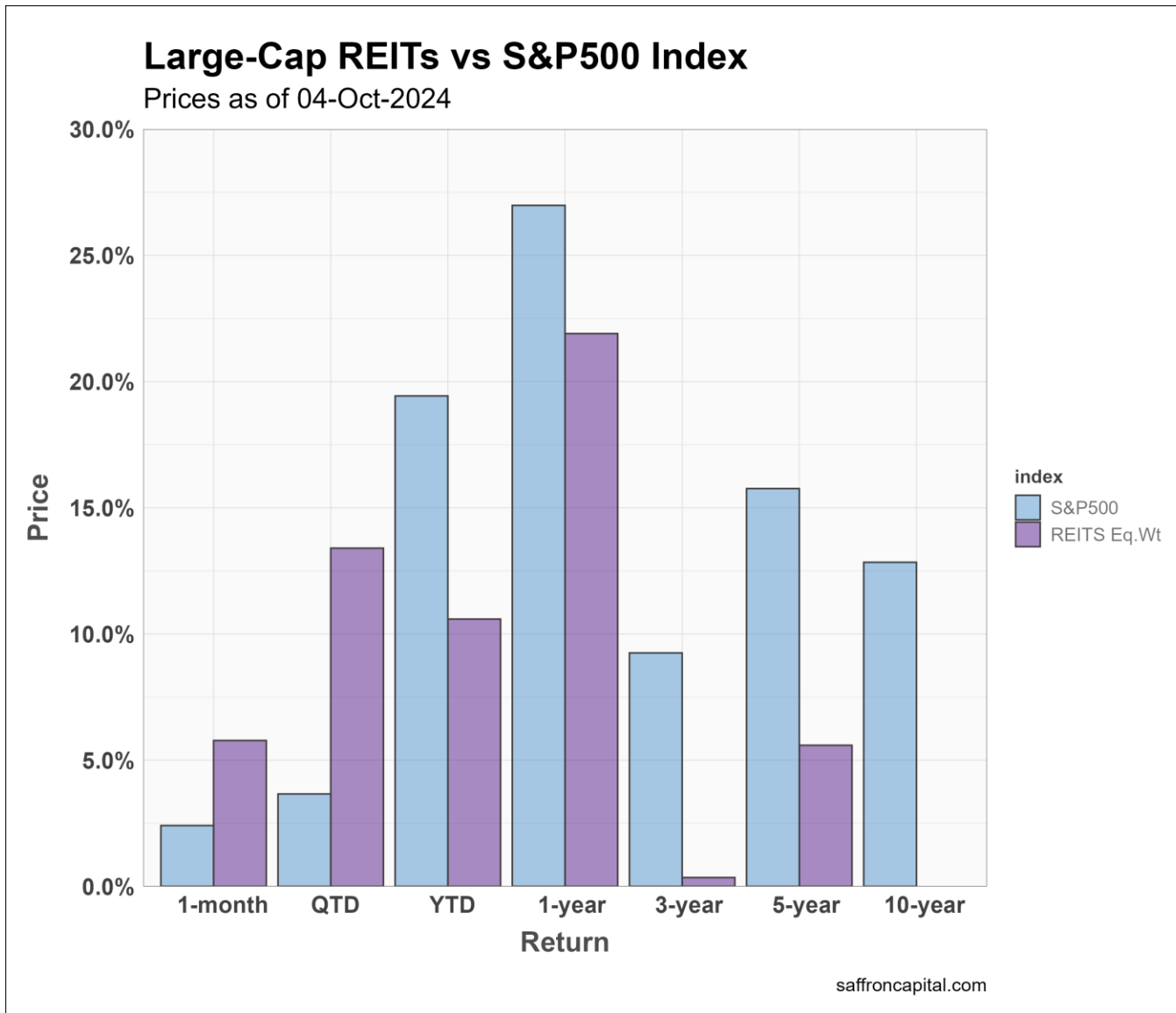
The second pass seeks to validate initial findings with deep-dive due diligence into original data, documents, and key source interviews. The goal: detailed cash flow models and input forecasts.

Part 7

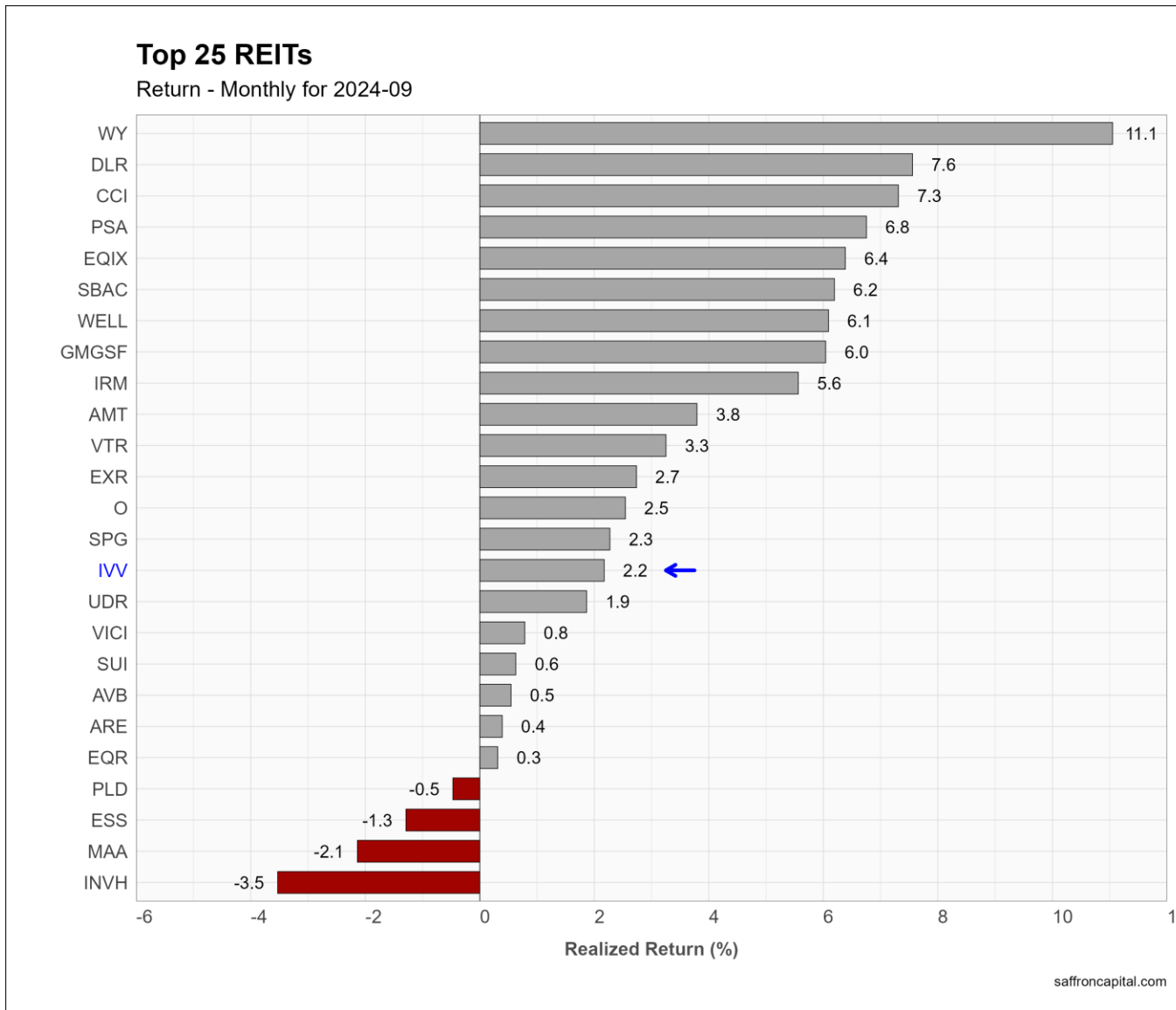
# REIT Performance Metrics



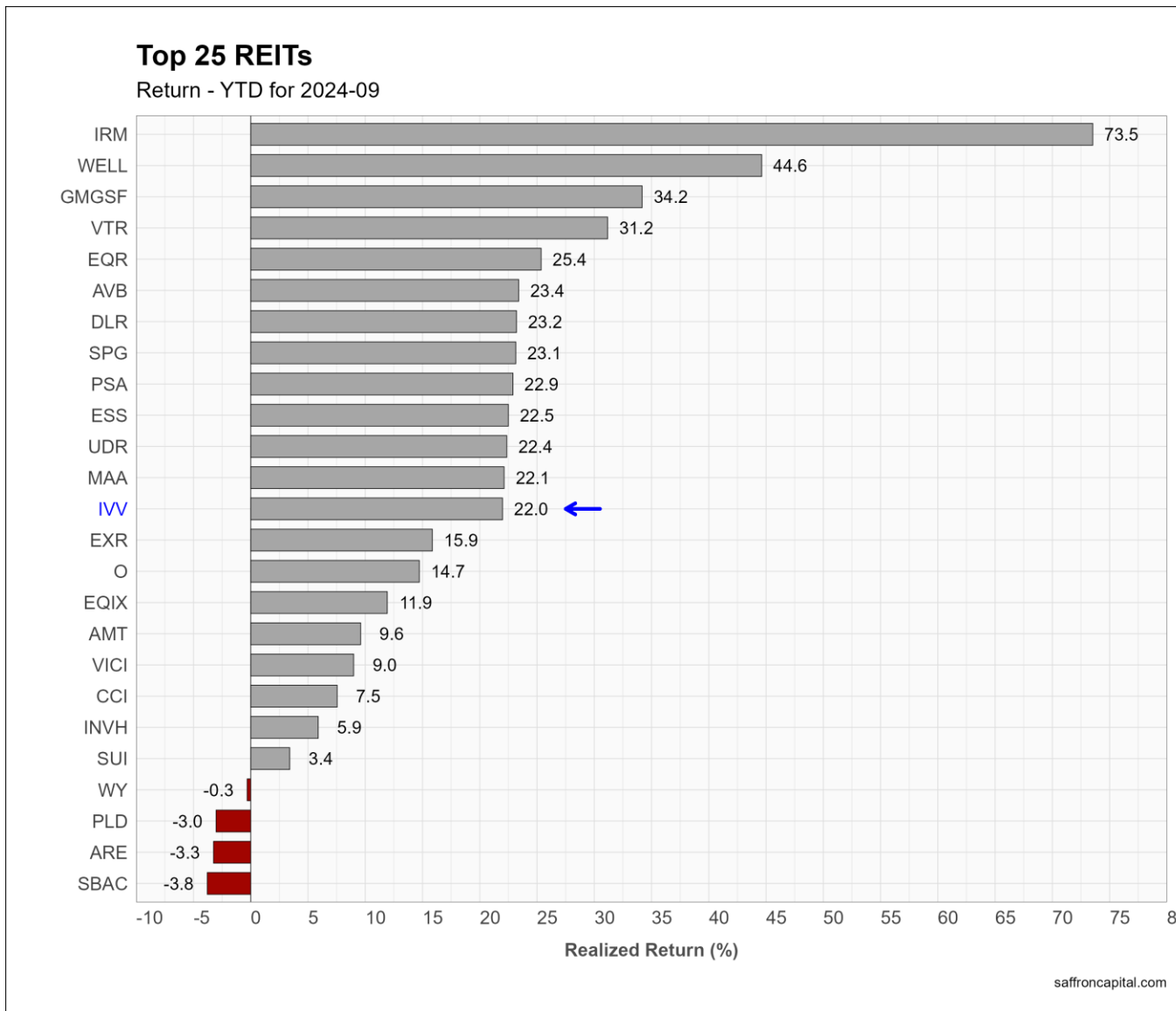
# REIT Performance



# REIT Performance



# REIT Performance



# Concluding Comments

REITS are hybrid securities. They provide variable income and capital gains potential tied to real assets and the stock market.

REITs are suitable for many investors. REITS differ by type, industry sector, and credit quality. Some REITs are riskier than others.

Detailed due diligence is required to understand any REIT portfolio or real estate specialization.

- Investors are encouraged to read trust company reports filed quarterly and annually with the SEC and stored in the SEC's Edgar System.
- Income statement and balance sheet reports contains key inputs to assess the REIT's ability to pay dividends, intrinsic value, target price and return potential

Screening REITS by key return factors can assist REIT selection

- Reliance on income statement and balance sheet metrics facilitate first pass selection, but additional due diligence is required to understand the business of each REIT and its unique risk/reward potential.