

Abstract: The stock market's roller coaster ride this year, spurred largely by the COVID-19 crisis, has many people craving stability. One way to potentially steady a portfolio is with real estate. This article looks at real estate investment trusts.

Is your portfolio ready for a REIT?

The stock market's roller coaster ride this year, spurred largely by the COVID-19 crisis, has many people craving stability. If volatility makes you nervous, it's important to maintain a diversified portfolio that won't plummet in value every time the Dow drops. One way to diversify your portfolio is with real estate.

This doesn't mean you need to go out and buy several apartment buildings or commercial properties and become a landlord. There's an easier, possibly less risky way, to gain real estate exposure — through a real estate investment trust (REIT).

Special entities

Although their name might imply it, REITs don't provide a direct investment in real estate. Instead, a REIT is a special kind of corporation that buys, sells and rents real estate on behalf of its investors. To qualify as a REIT, at least 75% of the company's income must come from real estate. Unlike normal corporations, REITs aren't required to pay taxes at the corporate level. In exchange for this benefit, they must distribute 90% or more of their rental income to shareholders in the form of dividends.

These property companies can be either private or publicly traded. Public REITs are like other public equities in that they trade on stock exchanges.

Income booster

Investors traditionally have turned to REITs to diversify their portfolios because they tend to perform differently from bonds and somewhat differently from the broad equity market, while generating long-term returns comparable to those of the latter. That said, the correlation between REITs and U.S. stocks has increased in recent years, which means that REITs may no longer provide quite the same diversification opportunities as in the past.

Many investors favor REITs for the securities' relatively large income stream. Individuals approaching retirement may look to REITs' dividends as a source of regular income. (But bear in mind that there's no guarantee that a REIT will distribute a dividend.) Liquidity is another important benefit, as REIT shares can be bought and sold on public markets. What's more, REITs give you flexibility to achieve your target real estate exposure because you can own the exact amount that fits your investment strategy.

There are drawbacks. For example, REIT dividends are taxed as ordinary income, which is subject to a higher rate than qualified stock dividends. But this could be mitigated somewhat because 20% of qualified REIT dividends may be available for the Section 199A qualified

business income deduction. One way to limit REITs' tax impact is to hold them in an IRA, 401(k) plan or other tax-advantaged investment account.

Weigh your options

There's no guarantee that REITs will appreciate or pay dividends. It's possible to lose money in such investments. Talk to a qualified investment advisor about whether a REIT might benefit your portfolio given your personal circumstances, long-term goals and risk tolerance. We can help you assess the tax impact.

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