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Why medical REITs are making news: Some investors like the diversification and potential

May 15, 2008 - Connecticut

What are REITs, and what is a medical REIT? REITs (real estate investment trusts) allow individuals a chance to own shares of major-league commercial properties like malls and office buildings through pooled investment. They started to become popular in the early 1990s. After income property values sank in the wake of the Tax Reform Act of 1986 and the savings and loan crisis, private real estate firms and individuals began purchasing commercial properties through REITs.

A medical REIT invests in properties like healthcare facilities, medical office buildings, and retirement and nursing homes. In 2006, one medical REIT bought nearly 800 properties in 44 states.1 Commonly, these REITs buy a property and lease it back to the healthcare provider through a net lease, with the REIT taking care of property management. REITs make money through rents and capital gains.

Are medical REITs attractive? With a medical REIT, you can invest in prime commercial real estate that is already professionally managed. So you can be a real estate investor without having to landlord, flip or exchange properties. You can even invest in REITs through mutual funds.

With the American population aging, demand is increasing for healthcare and long term care facilities to be built and leased. This is why many investors feel medical REITs will be popular regardless of what Wall Street does. Additionally, hospitals and healthcare providers constantly need capital. By selling a facility to a REIT, they get it. They can also get more debt off their balance sheets, and that may help their ratings improve.

How do medical REITs work? Most medical REITs are open market REITs - publicly traded companies. When you invest in them, you're buying shares, which typically sell for a modest premium above their NAV, or net asset value. (In 2007, many REITs were selling for less than their NAV.2) Other medical REITs are closed market REITs - start-ups that will go public in the future.

By law, all REITs have to pay out 90-100% of any income to shareholders each year.2 Dividends, are usually issued quarterly. According to the National Association of Real Estate Investment Trusts, REIT dividend yields were averaging 5.4% in late 2007, and the total return on REIT shares has averaged almost 11% annually since 1975.

There is usually no minimum investment requirement for a REIT, and open-market REIT shares can easily be converted to cash. As medical REITs are not directly correlated to the stock market, they attract investors who want diversification against volatility.

Investors have the opportunity to profit from medical REITs in the same way they do with all REITs: through dividends and the long-term appreciation of shares.

The ups and downs of medical REITs. Although past performance cannot predict future results, it is notable that the medical REIT sector has witnessed some significant annual gains. While 2007 was not a great year for medical REITs with yields typically in the single digits, the REIT healthcare sector delivered a 44.55% return in 2006.3 And during the last bear market, healthcare REITs delivered returns of 26% in 2000 and 52% in 2001.4

Of course, there are risks to medical REITs (and REITs in general). When the real estate market is bad, they suffer. When interest rates climb, their growth can be impeded. Their value may fluctuate based on economic, regulatory and environmental factors. Dividends are not guaranteed and may fluctuate from year to year. Also, closed market medical REITs are in a sense venture capital firms, and their sponsors and shareholders must pay close attention to changes in tax and securities laws. While the returns from these private REITs may typically exceed those of open market REITs, they don't offer an investor the same kind of liquidity or transferability.

Are these REITs for you? While they are not suitable for everyone, medical REITs are attracting some sophisticated investors. You can explore investing in medical REITs with the help of a qualified financial professional who understands their subtleties; your professional can determine if investing in such a REIT is appropriate for you based on your objectives, risk tolerance, and time horizon.

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